Fundamental Principles of Insurance Contract Law and Practice in the People's Republic of China

A Comparative Study with English and Australian Counterparts

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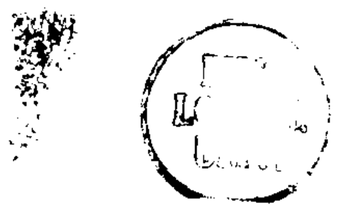

ABSTRACT

The Insurance Law 1995 (PRC) is the first comprehensive insurance legislation since the foundation of the People's Republic of China in 1949. It consists of insurance contract law and insurance regulation. This study concerns only the insurance contract law, focusing on three fundamental principles, namely the principles of insurable interest, utmost good faith, and subrogation. The main theme of this study is that, through examination and analysis, and by comparative methodology, of the provisions relating to the three principles, problems in these provisions are to be found and recommendations on how to amend them are to be proposed. It is intended this study will also help us to understand other similar problems in the whole Chinese insurance contract law.

Many concepts adopted in the Insurance Law (PRC) are English in origin. This research attempts to trace the origin and the evolution of these concepts in England and to seek their real meanings in order to find and solve problems of confusions, ambiguities, contradictions and unfairness in Chinese insurance law. The Australian Insurance Contracts Act 1984 codifies the common law and insurance practice in Australia and mitigates the common law for its harshness to consumers and is regarded as a model for insurance law reform. So many Australian approaches are suggested as suitable to follow in order to amend Chinese law.

This thesis starts with a brief introduction stressing the purpose and methodology of this research. Then the background is laid down concerning China's politics, economic reform, legal system and the development of China's insurance industry, under which the Insurance Law has been shaped. This is followed by three chapters - the main part of this study dealing with the three fundamental principles of the insurance contract law by examining and comparing the Chinese approach with the English and Australian counterparts. By doing so, problems in the Insurance Law are identified and better solutions are figured out. This research concludes with an emphasis on the urgency for amendment of the Chinese insurance contact law by summarising the preceding examination and analysis of the three principles. It finally ends with a number of proposed amendments of relevant provisions of the Insurance Law which it is hoped will provide useful models for the improvement of the whole Chinese insurance law.

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A Comparative Study with English and Australian Counterparts

Chapter One: Introduction

The law of insurance can be divided into two distinct topics. The first is the law of the insurance contract, which governs the legal relations between the insurer and the insured. A contract of insurance is one whereby one party (the "insurer") promises in return for a money consideration (the "premium") to pay to the other party (the "insured") a sum of money or provide him with some corresponding benefit, upon the occurrence of one or more specified events.[1] The second is insurance regulation, which can be generally defined as a mechanism used to control the behaviour of a participant in an insurance market.[2]

China's insurance contracts and its insurance industry are now governed by the Insurance Law of the People's Republic of China 1995 (hereinafter the Insurance Law)[3] which contains both the insurance contract law and insurance regulation. In this research, the law of insurance contract will be discussed.

1. Objectives and Scope of the Study

The Insurance Law 1995 is the first and the most comprehensive insurance legislation on insurance in China since 1949. Prior to the Insurance Law, there were three pieces

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[1] This is a working definition for the concept of contract of insurance derived from that given by Channell J. in *Prudential Insurance Company v. Inland Revenue Commissioners* [1904] 2. K.B. 658.
[2] See generally J.L.Brady, J.H. Mellinger & K.N. Scoles, Jr. The Regulation of Insurance, at 1-2, 1995.
[3] The Insurance Law 1995 (PRC) was adopted at the 14th Session of the Standing Committee of the 8th National People's Congress on 30 June 1995 and became effective as of 1 Oct. 1995.

of legislation relating to insurance contracts. These were the Economic Contract Law of the PRC 1981[4], the Regulation of the PRC on Contract of Property Insurance 1983[5] and the Maritime Code of the PRC 1992[6]. However, due to the fact that China's insurance industry has a short history[7] and the Insurance Law is a new law which was drafted under the circumstance that China's insurance business had re-established for only more than a decade since 1980 and not much experience had been accumulated about the insurance business and the drafting of insurance law,[8] it is inevitable that some problems and shortcomings appear in this new law. So the Law needs further improvement in many aspects in order to make it fairer for both insurers and insurance consumers and to make it harmonious with the fast growth of the Chinese insurance industry and the rapid expansion of the insurance market as well as to keep it in line with international practice[9].

Although the Insurance Law represents a great progress on Chinese insurance legislation generally, some confusion, ambiguities, contradictions and unfairness still appear in the Law. There are also a number of lacunae for some important respects.[10] Although the Insurance Law provides more detailed rules governing insurance

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[4] It was adopted by the 4th Session of the 5th National People's Congress (NPC) on December 13, 1981. Arts. 25 and 46 deal with matters of insurance contract. The Economic Contract Law was repealed by the Contract Law 1999 (PRC).

[5] It was promulgated by the State Council on September 1, 1983. This Regulation may still have effect where not repealed by the Insurance Law 1995.

[6] It was adopted at the 28th Meeting of the Standing Committee of the 7th NPC on Nov. 7, 1992 and become effective on July 1, 1993. Chapter 12 (arts. 216-256) deals with the matters of marine insurance. According to art. 147 of the Insurance Law 1995: "Marine insurance shall be governed by the relevant provisions of the Maritime Code. Matters not provided for the Maritime Code shall be governed by the relevant provisions of this law."

[7] Modern insurance activities were introduced into China as late as the middle of the 19th century by foreign insurers. China's modern national insurance industry emerged from 1875. Due to many reasons, China's national insurance industry did not develop significantly until 1980. Chinese domestic insurance was suspended for 20 years from 1959 to 1979, only some foreign-related insurance business was maintained during that period. Since 1980, when China launched economic reform and opened the door to the outside world, China's insurance industry has been developing rapidly and significantly. For the details of the evolution and development of China's insurance industry, see Chapter two, *infra*.

[8] See Chapter two "China's Insurance Industry and Insurance Law" of this thesis for details.

[9] Before 1986, the People's Insurance Company of China (PICC) was the only insurance company in China and so monopolised China's insurance market. Since 1986, more and more insurance companies have been set up including both national insurance companies and foreign ones. By the end of 2000, there were 30 insurance companies in China, of which 13 were Chinese national insurance companies and 17 were foreign insurance companies. (For China's current insurance market, see Chapter two, *infra*). China expects to join the World Trade Organisation (WTO) in the near future and then its insurance market will open further to foreign insurance companies.

[10] For example, the Insurance Law does not mention at all the important doctrine of "proximate cause", and there are no detailed provisions relating to the requirement of insurable interest in property insurance in the Law.

contracts than previous laws or regulations relating to insurance, it is still a "skeleton" and waits for "flesh". There is a lack of complementing rules on the insurance contract law[11] for insurance parties to abide by or a lack of judicial explanations regarding the insurance contract law for judges to follow on dealing with insurance disputes. Moreover, there is a shortage of judicial precedents regarding insurance. To date, only a handful of reported insurance cases have been found, and these cases are often devoid of detailed discussion on the applicable legal principles. In practice, in many aspects there are no corresponding laws and rules to be followed when courts settle disputes about insurance contracts. Judges usually base their judgements on their own understanding of the insurance law. Therefore it is not surprising that different decisions may be made now and then for similar cases. New situations on insurance keep occurring in the environment of the fast changes of the Chinese economy and society and of the emergence of the liberalisation of international financial services, therefore, there is a dire need for an in-depth study of the provisions of the insurance contract law in order to improve it to meet the new circumstances. However, as far as it is known, nobody (either domestic scholars or scholars abroad) has done such sort of research, especially not any detailed treatment on Chinese insurance law in English. There are no main stream works on Chinese insurance law with deep and detailed discussion or examination on matters of insurance law similar to some English works on insurance[12] although there are some Chinese books which give only a brief introduction or description or explanation on the Chinese Insurance Law.[13] It is hoped

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[11] No complementing rules for the insurance contract law have been made in China. There are some complementing rules for the part of insurance regulation of the Insurance Law. The Tentative Regulation on Administration of Insurance Enterprises 1996, the Regulation on Administration of Insurance Agents (on trial) 1997 and the Regulation on Administration of Insurance Brokers (on trial) 1998 were enacted by the People's Bank of China (PBC). The Regulation on Administration on Insurance Companies was enacted by the China Insurance Regulatory Commission in 2000. The China Insurance Regulatory Commission (CIRC) was established in Nov. 1998 and it acts as the Financial Supervision and Control Department. Before 1998, the PBC functioned as the Financial Supervision and Control Department (FSCD).

[12] In England, there are some main stream works written by some authorities on English insurance law which are even regarded as one sort of legal sources on insurance law, such as MacGillivray on Insurance Law, the first edition was done by MacGillivray E.J. in 1912, and it has been re-edited every several years by different editors, the latest edition (9th ed.) was made by Nicholas Legh-Jones Q.C., Sir Andrew Longmore, John Birds and David Owen. See also Merkin R. Insurance Contract Law (Loose leaf); Merkin, Colinvaux's Law of Insurance; Clarke M. A., The Law of Insurance Contracts; Arnould, Joseph, Sir. . Arnould's Law of Marine Insurance and Average, etc.

[13] See Ding Yunzhou. Zhongguo Baoxianfa Jianming Jiaocheng (A Course of Chinese Insurance Law), China Banking Press. 1995; Sun Jilu, Baoxianfa Lun (A Brief Introduction of Insurance Law), Chinese Legal Affair Press. 1997; Li Yiran and Jin Zhi, Baoxian Bidu (Introduction to Insurance Law), 1996; Huang Huaming. Zhongguo Baoxianfa Lilun yu Shiwu (Theory and Practice of Chinese Insurance Law), 1996; and Yu Xinnian, Zuixin Baoxianfa Tiaowen Shiyi (The Most Recent Interpretation on the

that this study can make a significant contribution to the improvement of the Chinese Insurance Law. This is one of the main reasons which drive me to do this work.

In addition, the Chinese legislators made efforts to make the law consistent with international insurance practice by introducing some commonly accepted concepts, but it seems, to a certain extent, it is only a superficial legal transplant without introducing the essence of the concepts. Consequently, confusions are caused in the Insurance Law. However, since the enactment of the Insurance Law, nobody has made any attempt to trace the origins of the concepts or rules to pursue their essence and values to test whether the Chinese Insurance Law adopts the concepts and rules in essence and if those concepts and rules are suitable to Chinese own situation. It is hoped this study will fill this gap.

Whether the Insurance Law, in its actual working, can achieve the intended functions as expressly and implicitly stated in the law, in addition to a clear and correct construction for the various provisions of the law, also depends on how the law is implemented in practice. The law is there, but it has not been implemented strictly in practice deliberately or negligently either by the parties to insurance contracts or by judges when they settle insurance disputes. Thus gaps between the law and practice appear.

English insurance has a long history and has developed relatively steadily since its emergence. English insurance law has a good reputation in the world and London is the centre of the insurance business world-wide. Lots of countries follow the principles of English law in making their own insurance laws. For example, the Marine Insurance Act (hereinafter MIA) 1906 (UK) is regarded as a model of marine insurance law by other countries and is still the main code to be followed world-wide in dealing with marine insurance affairs. Furthermore, the English legal system is a common law system, and the precedents have force of law unless and until overturned by a judge in a higher court or by Parliament. Statutory laws are sometimes made by codifying case laws and rules of practice. Where the statute is brief or a "skeleton", case law complements the statute. In England, insurance statutes combine with the

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Insurance Law), 1995.

common law to establish the basic legal framework for insurance operations. However, it has long been recognized that in some aspects English insurance law seems to be too harsh towards insurance consumers. The Statements of Insurance Practice of the Association of British Insurers (hereinafter ABI)[14] – the self-regulation scheme of the British insurance industry – and the Insurance Ombudsman Bureau (hereinafter IOB)[15] – the dispute-handling scheme for individual consumers who are insureds – to some extent mitigates the harshness of the English law for the insureds. However, as the statements of the ABI and the IOB scheme have no legal force, law reform is still needed in England.[16]

In Australia, before the promulgation of the Insurance Contracts Act (hereinafter ICA) 1984 and the Insurance (Agents and Brokers) Act 1984, the Australian law of insurance was in the main based on common law as developed by judicial decisions. That situation was radically altered by these two Acts which have an enormous impact upon common law in respect of the insurance contracts. Generally speaking, the Australian ICA 1984 and the Insurance (Agents and Brokers) Act 1984 are consumer oriented Acts which, in many aspects, mitigate the common law's harshness towards

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[14] The Association of British Insurers represents around 430 insurance companies which between them account for over 96% of the business of UK insurance companies. Lloyd's is not a member of the ABI but is a member of the Insurance Ombudsman Bureau (IOB). The Association represents insurance companies to the Government and to regulatory and other agencies, and it provides a wide range of services to its members. The Statements of Insurance Practice of the ABI, first published in 1977, were openly acknowledged as the price paid by the insurance industry of exemption from the Unfair Contract Terms Act 1977. The Statement of General Insurance Practice was last revised in 1995 and that on Long Term Insurance in 1986. These statements aim to temper the strictness of some aspects of the insurance law.

[15] The IOB was set up in 1981, the first of the private ombudsman schemes. Its purpose is "to resolve disputes between members and consumers in an independent, impartial, cost-effective, efficient, informal and fair way". (Annual Report 1995). It was one of the two complaints mechanisms, for individual consumer insureds, outside the traditional court structure in Britain. The other complaint mechanism is the Personal Insurance Arbitration Service (PIAS). The membership of the IOB now comprises general insurers covering 90% of private policyholders. Lloyd's joined the IOB in 1989. The IOB bears complaints only when all internal mechanisms within a member company, up to chief executive level, have been exhausted. The service is free to complainants and the Ombudsman can make awards of up to £100,000 which are binding on member companies. However, the consumer is not bound by a decision of the Ombudsman. The IOB itself is an unlimited company without a share capital, with a board of directors appointed as representatives of the member insurers. It has an independent Council (the majority of whose members are not insurance industry people) which appoints the Ombudsman. Very rarely does the Ombudsman actually exercise his power to make a formal award; rather, most cases are disposed of by way of conciliation. It has been said, recently, that the IOB will be merged with the Financial Ombudsman Service (FOS) – resolving disputes between consumers and financial firms. This will be completed by the legislation at the end 2001. For more information about IOB and the FOS, see http://www.financial-ombudsman.org.uk/ABOUT/ index.html.

[16] See Professor J. Birds, Insurance Law Reform, the Consumer Case for a Review of Insurance Law, Published by the British National Consumer Council, 1997. No action has yet been taken on any of its recommendations.

insurance consumers. It has been suggested by some English reformers that the Australian ICA 1984 and the Insurance (Agents and Brokers) Act 1984 be taken as a model by which to reform English insurance law.[17]

The main purpose of this research is to attempt to find better solutions to the problems in the Chinese Insurance Law and practice through comparing and analysing the similarities and differences of the fundamental principles of insurance contract law, namely, insurable interest, utmost good faith and subrogation and their application in China, England and Australia (and other countries and regions, if needed). Although China, England and Australia have different social and legal systems, insurance business is a business with high internationalism, and there are some common features and universal rules in the insurance laws and practices of all countries in the world. China expects to join the World Trade Organisation (WTO) in the near future and has promised to open the insurance market even further to the world. Consequently, more foreign insurance companies will be granted access to China's insurance market. Chinese national insurance companies will face sharp competition from the foreign insurance companies. To a great extent, Chinese insurance companies have to transact business by following internationally recognised rules and practices; this indicates that the Insurance Law should be further amended to adhere to the international standards of insurance practice.

Another purpose of this study is to make interpretation on relative provisions of the Chinese Insurance Law (which has not been made by either Chinese legislator or the Supreme People's Court) with reference to and sometimes invoking English and Australian solutions. It is not intended to bypass unequivocal Chinese rules by using English and Australian solutions, but, when the construction of a Chinese rule is doubtful or where there is a lacuna in Chinese law, it may be necessary and useful to invoke an English or an Australian solution.

Finally, this study expects to provide a "window" for foreign insurers and businessmen, through which they can look into Chinese insurance laws. This purpose has two possible meanings. On the one hand, since the economic reform and the open-

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[17] *Ibid.*

door policy, a large number of foreign businessmen have set up business in China, and many others are finding their way to trading with the Chinese, and they need insurance protection to back them up. Understanding Chinese insurance laws and practice is important for them in formulating and carrying out well informed investment or business planning in China. On the other hand, China's huge insurance market has been attracting foreign insurers to establish insurance businesses in China. According to the Insurance Law, "the establishment of an insurance company with a foreign equity or the establishment of branches in the People's Republic of China by foreign insurance companies shall be governed by this Law, or other laws and administrative rules and regulations if they provide otherwise."[18] Accordingly, the foreigners who intend to set up or have set up their insurance businesses in China have to follow the Chinese Insurance Law to transact their businesses. This study attempts to provide foreigners with a useful reference for their efforts to understand Chinese insurance law and practice.

2. Methodology for This Study

Law is the result of human wisdom for the benefit of mankind. The idea that no one nation has a monopoly of wisdom applies just as strongly to law as to any other field of human endeavour. This has provided the foundation for comparative law studies.

This study is undertaken by a comparative approach. Comparative study of laws between two or more legal systems is a better way to improve one's own nation's law.[19] This study will follow the methodology commonly employed in comparative law research. It goes without saying that through comparative study, some similarities and differences between the Chinese, English and Australian laws will be found. However, it is not the purpose for comparative study just to list the similarities and differences, or only to critically analyse the reasons for the similarities or differences, the purpose is to show the way to a better mastery of the legal material, to deeper

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[18] Art. 148 of the Insurance Law.

[19] Comparative law has various functions and purposes. As Peter de Cruz summarised comparative law can be adopted as (a) an academic discipline; (b) an aid to legislation and law reform; (c) a tool of construction; (d) a means of understanding legal rules; (e) a contribution to the systematic unification and harmonisation of law. See Peter de Cruz, Comparative Law in a Changing World, (2nd ed.), p.18, Cavendish Publishing Limited. 1999. See also Chapter six "Conclusion and Recommendations" of this thesis, *infra*.

insights into it, and thus, in the end, to improve the Chinese law.

In this study, whenever it is proposed to adopt an English or Australian solution which is said to be superior, two questions will be considered: first, whether it has proved satisfactory in its own country; secondly, whether it will work in China where it is proposed to adopt it. It may well prove impossible (or possible) to adopt, without modification, another country's solution because of (or in spite of) differences in cultural tradition, legal system, the powers of various authorities, the working of the economy, or the general social context into which it would have to fit. All these will be critically evaluated. It is more important that when using comparative method to reform local laws, precautions must be taken to avoid superficial or misguided legal transplants. Although it may be difficult and unnecessary to understand the whole legal system of the country from which one wishes to borrow some legal rules or ideas, nevertheless, it is necessary to understand that particular piece of law which one wishes to introduce into his own country's law. One must thoroughly understand the meaning of the rules not only the words of the rules, but also their values and underlying principles, as well as the implementation, the constraints, limitations and extensions of the rules in their country-specific circumstances. Otherwise, one may transplant the foreign rules superficially, but leave the essence of the rules behind.[20]

The search of materials includes two approaches, namely literature survey and fieldwork. The main sources for literature survey are the law reports, statutes, books on insurance law written by authorities and relevant articles in law journals. Field work includes interviewing personnel and managers of some insurance companies in China and in England, and discussing with them matters related to this study, and interviewing some authorities in Chinese insurance law, communicating with my former colleagues who are working in various insurance companies in China by letters, email, fax and telephone to discuss matters relating to this study.

It would be impossible to examine all aspects of the insurance contract law in such sort and size of research. Instead, this study focuses on three fundamental and unique

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[20] For the detailed discussion on perils of comparative law, see Alan Watson, Legal Transplants – an approach to Comparative Law, (2ne ed.), p. 10 –16, The University of Georgia Press, Athens and London, 1993.

principles of insurance contract law, namely, the principle of insurable interest, the doctrine of non-disclosure and misrepresentation and the principle of subrogation, because not only they are the fundamental principles, but also their application and the rules derived from them have been the focus of arguments in insurance contract law world-wide. Thus they merit a special examination. It is also hoped that detailed examination and critical analysis on these three principles would help us to understand similar problems in the other areas of the Insurance Law.

Each investigation into one of the principles begins with the posing of a question or setting of a work hypothesis – in brief, an idea. Often it is the feeling of dissatisfaction with the solution in Chinese law which is the driving force for me to look for a better solution. Contrariwise, it may sometimes be the pure study of the English or the Australian approach which sharpens my criticism of Chinese law and so produces the idea or working hypothesis. In other words, the idea comes from the critical appreciation of Chinese law and the constant study of English law or Australian law.

For some specific problems, such as the test of materiality for non-disclosure and misrepresentation and the voluntary disclosure of material facts, it would be unprofitable and misleading to compare parts of a solution only. Comparing only the statutory rules or doctrinal principles should be avoided, for the principles are sometimes qualified by exceptions or by so called self-regulation. What actually happens in practice can sometimes weaken the operation of a statutory law and common law. For example, according to the MIA 1906 (UK)[21] and common law[22], the test of materiality should be the prudent insurer mere influence test and the voluntary duty to disclose material fact to the insurer was imposed on the insured. However, the application of the Statement of the General Insurance Practice of the ABI and the impact of the rulings of the IOB make the statutory law and common law in this respect not strictly applicable in many instances where the insured is an individual consumer. This gives consumers a better deal than the strict law would allow.

Finally, after a critical evaluation of what has been found, a better solution, if possible,

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[21] See s. 18 of the MIA 1906 (UK).
[22] See *Container Transport International Inc. v.Oceanuns Mutual Underwriting Association (Bermuda) Ltd.* [1984] 1 Lloyd`s Rep. 476.

for a legal or practical problem is figured out, a reasoned conclusion is given and recommendations for amendment of the Chinese Insurance Law are also brought forth.

3. Outline of Chapters

Although this research concerns the fundamental principles of insurance contract law and practice in China, England and Australia, one can hardly understand why the Insurance Law 1995 (PRC) came into existence so late and why there are so many problems in the Law without a fair knowledge of the background of China's political, economic and legal system and the development of China's insurance industry. So this thesis starts (in chapter two) with a brief introduction to the political and economic background of China, including traditional China, modern China and China today. Then the development of China's insurance industry is examined. The reasons are given why China's insurance industry developed so slowly and unevenly before 1980 when China launched economic reform and opened the door to the outside world and why it has been growing so rapidly since then. At the end of this chapter, a brief introduction of Chinese legal system and the legislation in China is provided, including the background of the establishment of the Insurance Law.

From chapter three to five, I concentrate on the examination and discussion on the three fundamental principles by comparison of the different approaches in Chinese, English and Australian insurance laws and practice in an attempt to pursue the origins and values of the principles and to find some similarities and differences about the principles between the three nations and to give reasons why the similarities and differences exist by analysing the three countries' economic, legal system and social background. The eventual aim is to identify the problems of Chinese insurance law and find better solutions from English and Australian laws so as to introduce them to China or take them as a reference to make suggestions for improving Chinese insurance law.

Chapter three is concerned with the principle of insurable interest and its application in China, England and Australia. One of the things which distinguish contracts of insurance from general contracts is the requirement that the person who takes out

insurance or for whose benefit the policy is effected has to show that he has an insurable interest in the subject matter of the insurance. The failure to show this interest leaves the purported insured in peril of being uninsured for the risk which he perceives since the contract would be null and void. Due to the differences in social, cultural and economic background between China, England and Australia, the requirement of insurable interest by Chinese, English and Australian insurance laws is different. In this chapter, it is intended to find some shortcomings in the Chinese Insurance Law relating to insurable interest and to find the advanced aspects from English or Australian approaches relating to insurable interest.

Chapter four concerns matters of non-disclosure and misrepresentation. The doctrines themselves have stood in an unchallenged position in governing insurance activities since its birth; some rules derived from them and the ways of their application in practice have, however, raised arguments. For instance, the core of the issues relating to the doctrines of non-disclosure and misrepresentation is the test of materiality, the test in different countries is very different. In England, the prudent insurer mere influence test has been adopted[23] but it has been heavily criticised due to its harshness towards consumers. In Australia, the ICA 1984 adopts the reasonable person test[24] which seems to mitigate the common law position in this respect, whereas, in China, the prudent insurer decisive influence test is to be determined according to the meaning of article 16 of the Insurance Law and by referring to the English prudent insurer test. Another important issue is which way is reasonable to perform the duty of disclosure. In England and Australia, voluntary disclosure has been adopted by the law, *i.e.* parties are bound to volunteer to each other before the contract is concluded all information which is material.[25] However, the harshness and unfairness of the wide-ranging duty of voluntary disclosure have been largely mitigated for consumers by the self-regulation of the ABI – which frames and adopts voluntary statements of insurance practice that have modified the strict law. In China, the narrow way – inquiring disclosure – has been adopted by the Insurance Law.[26] Which way is better and reasonable is the question to be considered in chapter four.

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[23] See s.18 of the MIA 1906 (UK) and the case of *Container Transport International Inc. v. Oceanus Mutural Underwriting Association (Bermuda) Ltd.* [1984] 1 Lloyd's Rep. 476.
[24] See. s. 21 of the ICA 1984 (Australia).
[25] See s. 18 of the MIA 1906 (UK); s. 21 of the ICA 1984 (Australia).
[26] Art. 16 of the Insurance Law.

Other matters relating to non-disclosure and misrepresentation are also discussed in Chapter four, such as the effect of non-disclosure and misrepresentation, the duration of the duty, insurer's duty of disclosure and basis of the contract clause. Moreover, in China, a wide gap exists between law and practice; examples showing this gap are given in this chapter. Finally, a conclusion is drawn by summarising the problems relating to non-disclosure and misrepresentation in the Insurance Law.

Chapter five deals with matters of subrogation. Subrogation is another important principle in insurance contract. This principle is applicable only to indemnity insurance contracts. First, the nature and justification of subrogation in insurance contract (to prevent unjust enrichment) are considered in this chapter. Then some confusions and contradictions between provisions in the Insurance Law (such as, subrogation and assignment, subrogation and abandonment) are discussed. Thirdly, two limbs of subrogation are considered, *i.e.* the insurer's right to recoup the payment from the insured's compensation made by a third party and the insurer's right of subrogation against a third party. Matters about difference between subrogation and contribution and the application of these two doctrines are also examined. Fourthly, the relation between legal subrogation and contractual subrogation is considered. And then a brief conclusion for this chapter is drawn finally.

The final chapter presents a general conclusion of this research and sets out my recommendations for amendment to the articles in respect of these three principles in the Chinese Insurance Law. These recommendations are intended to be a model contributing to the general amendment for the Insurance Law.

This thesis is based on the laws and materials available as in May 2001.

Chapter Two: China's Insurance Industry and Insurance Law

1. China's Political and Economic Background

China is one of the countries with the longest history in the world and is the largest country on the earth in terms of population. The area of China is roughly 9.6 million square kilometres and nearly 1.3 billion Chinese people[1], which account for around 22 percent of the global population, reside in this vast country. China is a unified multi-national country with 56 nationalities. It now has 31 provinces, autonomous regions and municipalities[2] and 2 special administrative regions[3].

In ancient times, the polity of China was a dynasty ruled by an imperial family; the economy was basically agrarian and self-sufficient, in many ways it was "natural economy" with a relatively low degree of commercialisation. The traditional industries were very small consisting mainly of handicrafts. During the last few hundred years, the Chinese believed their Celestial Empire was the centre of the universe. The rulers of China believed they needed nothing from the outside world. The Opium War shattered the closed door of China. The Qing government's long-standing policy of isolation was broken down in the face of European military superiority.[4] From then on, feudal China was gradually reduced to a semi-colonial and semi-feudal society. China was then transformed from traditional China into modern China. The treaty of Nanking opened China to the western traders and other foreigners. The growth of foreign settlements or concessions had an important influence on Chinese subsequent economic development. For the first time the methods of large-scale commercial organisations and modern financial institutions were introduced into China.

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[1] According to the latest nation-wide census of China in Nov. 2000, the population in China is around 1295.33 million. See http://www.sbweb.com/gb/people-daily/2001/03/29/a0329001.htm.

[2] *Ibid.*

[3] Hong Kong and Macao.

4.The Chinese were defeated in 1842 by the European forces. The Qing Emperor's representatives signed the first unequal treaty - the "Nanking Treaty" - in which the cession of Hong Kong to Britain was confirmed and an indemnity to them was approved. As well Amoy, Fuzhou, Ningbo, Shanghai and Guangzhou were also to be opened to British traders and residents, making five treaty ports. Foreign businessmen were allowed to do business freely in the treaty ports.

In modern times, China has changed drastically. During the mid-nineteenth century, because of the corruption and incapacity of the Qing government, internal rebellions often arose. The Qing dynasty began to decline because of the pressure of foreign powers and internal rebellions. The final collapse of the Qing dynasty was caused by an onslaught of the 1911 Revolution led by Sun Yat-sen (the most famous revolution in China's history). Sun established the Republic of China which brought an end to the imperial system in China, and founded the Nationalist Party or Guomindang (GMD) The authority of the Republic, however, soon collapsed, China then entered a decade of warlord rule, and the country was divided up among provincial warlords. The warlords fought each other for the control of territory and revenue during these years (1912-1927). Most of the country fell within the sphere of influence of one foreign power or another. As a result development came almost to a standstill.

The warlords were overthrown by the united forces of the Nationalist Party or Guomingdang (hereinafter GMD) led by Sun Yat-sen and the Chinese Communist Party (hereinafter CCP)[5]. When Sun Yat-sen died, Chiang Kai-shek, the commander of the army of the Nationalist Party, took over the power. On the one hand, Chiang functioned as a modern-style Nationalist leader. He eliminated most of the foreign spheres of influence and unified significant portions of the country. He maintained a respectable rate of industrial growth, and built roads, telephone lines, railways and so on.[6] On the other hand, in his political manoeuvring, Chiang was sometimes functioning as a warlord. He distrusted his subordinates and tried to keep them from becoming too powerful. He was deeply suspicious of communist influence, and ordered the Shanghai massacre of communist labour leaders. From then on, China was taken into ten years of civil war (1927-1937) between the GMD and the CCP which terribly hindered the development of China's economy. The Sino-Japanese War (1937-45) made China's economy worse. It caused serious damage to China's industry and commerce.

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[5] The CCP was founded in 1921 in Shanghai with some encouragement from the Soviet Union.

[6] By 1937 there were about 7,000 miles of railways, and highway mileage had expanded from 20,000 in 1927 to 75,000 in 1937. Air lines linking the major cities were build up as well. In some major cities, there was a fairly rapid expansion of modern business. See Hughes T.J. and D.E.T.Luard, The Economic Development of Communist China, (1949-1960) p.14, 1962.

After the Sino-Japanese War, the GMD was, once again, engaged in civil war against the CCP from 1946 to 1949. The final victory of the CCP ended the civil war. The People's Republic of China (PRC) was established with the new central government and the capital in Beijing in 1949. The CCP was, from its origin, a fully Marxist Party. The Russian Revolution had exerted a profound impact on the CCP. The declared aim of the party since the very beginning had been the establishment of fully socialist society in China, in which all the means of production and distribution should be in the hands of the state. The new government began to devote itself to long-term recovery and rehabilitation of the battered economy.

Post-1949 economic development can be divided into three stages:

Firstly, there was economic rehabilitation (1950-1952) and the First Five Year Plan (1953-1957). The primary goal of the government for the period of 1950-52 was simply to restore the economy to normal working order. In the cities, transportation, communication, banking and industry were developing rapidly.[7] In the countryside the major undertaking of the new government was Land Reform which led to a rapid recovery in agricultural output to the best pre-1949 levels.[8] Commerce was stimulated and partially regulated by the establishment of state trading companies in all the larger towns and cities which competed with private traders in purchasing goods from producers and selling them to consumers or enterprises. The volume of internal exchanges was increased. At the same time efforts were made to restore China's foreign trade.

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[7] During 1950 - 1952, the administration moved quickly to repair transportation and communication links and revive the flow of economic activity. The banking system was nationalised and centralised under the People's Bank of China (which was founded in 1948). The monetary system was unified and credit was under central control. See Frederica M. Bunge, China - A Country Study, p. 169, 1981. The industrial record is even more impressive. The gross value of industrial production, excluding that of individual handicraftsmen, more than doubled between 1950 and 1952. By the end of 1952, its industry had left the pre-1949 peak production figures well behind. See Solomon Adler, The Chinese Economy, p. 24. Routledge & Kegan Paul, London, 1957.

[8] Land Reform was initially instituted in many of the liberated areas of China prior to October 1949, and swept through most of the country in the period of 1950 to 1952. It involved principally the redistribution of land from landlords and, to a lesser extent, rich peasants to poor and landless peasants. See Christopher Howe, China's Economy, p. xxii, 1978.

Having restored a viable economic base, the First Five-Year Plan was drawn up and put into practice in 1953. That was when China started its centrally planned economic system.[9] The main target of the Plan was to double industrial output. In terms of economic growth the First Five-Year Plan was quite successful. A very solid foundation was created in heavy industry.[10] The socialist transformation was completed during this period.[11] Agriculture also underwent extensive organisational changes during this period.[12]

Secondly, came the Great Leap Forward (GLF, 1958-60) and the adjustment after GLF (1961-65). The Great Leap Forward meant that in a short time an explosive "great leap" in production in all sectors of the economy should be made.[13] Extreme technological dualism "walking on two legs" led to centrally controlled, large-scale, modern, capital-intensive enterprises accompanied by locally controlled, small-scale, technologically backward, labour-intensive plants such as the familiar "backyard steel furnaces". Local industrialisation was meant to mobilise all unused resources (including

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[9] The Chinese centrally planned economic system was characterised by strict vertical control. Plans were drawn up, implemented and supervised by government organisations at various levels from the centre. The National People's Congress (NPC), at the apex of China's State structure, was formally responsible for law making, approval of government documents, appointment of senior government officials and national economic planning. The most important executive organ was the State Council. The State Council's role was to carry out detailed work in accordance with general principles approved by the NPC. Thus it formulated administrative measures, exercised leadership over the central ministries, commissions, bureaux and local authorities, and drafted and carried out the national economic plans. Directly under the State Council there were two important organs responsible for special planning work - the State Planning Commission (for long-term planning) and the State Economic Commission (for short-term economic planning). The Chinese planning system involved long-, medium-, and short-term plans. Five Year Plans, officially termed National Economic and Social Development Plans, were the principal medium-term plans. Under the guidelines laid down by Five Year Plans, annual plans were drawn up and directly controlled short-term economic activity.

[10] The key industries, including iron and steel manufacturing, coal mining, cement production, electricity generation, and machine building, were greatly expanded and were put on a firm modern technological footing.

[11] By 1956 of all modern industrial enterprises 67.5% were state-owned, 32.5 % were under joint public-private ownership, and no privately owned firms remained. During the same period the handicraft industries were organised into cooperatives, which included 91.7% of all handicraft workers by 1956. See Frederica M. Bunge, China - A Country Study, p.170, 1981.

[12] Peasants were encouraged to organise increasingly large and socialised producer cooperatives in the countryside on the basis of Mutual Aid Teams. A typical Elementary Agricultural Producer Cooperative consisted of 20 to 25 households. In 1956, most peasants joined the Advanced Agricultural Producer Cooperatives which involved 150 to 200 households. See Alexander Eckstein, China's Economic Revaluation. pp.66-108, Cambridge University Press, London, New York. 1977.

[13] In May 1958, at the second meeting of the Eighth Chinese Communist Party Conference, the general line put forward was that of "putting forth our greatest effort, striving to be among the most advanced economies and building up socialism with faster, better and more economical methods". See Johnson D., Economic Reforms in the People's Republic of China, vol. 36, No.4, 1988.

surplus labour), supply consumer goods to the surrounding population and supply inputs to and process the output of agriculture. Surplus labour in agriculture (having a low or zero marginal product), it was assumed, could be redeployed at virtually zero opportunity cost, especially when this was accompanied by deep ploughing and close planting. The idea was that this labour could be used to operate the small enterprises needed to increase the degree of rural/industrial interdependence and to build up the agricultural infrastructure, such as dams and irrigation schemes.

In agriculture, the framework for the Leap was a new form of agricultural organisation - the People's Commune. In August 1958 the Central Committee endorsed People's Communes, which grouped together 2,000 or more households in an organisation combining economic, political, and militia functions. Soon the whole of the Chinese countryside was organised into about 26,000 communes, containing an average of almost 5,000 households each.[14] The ultimate goal of the communist movement is a communist society, in which there will be no connection between the labour people do and the incomes they receive. Everyone will work because that is their obligation as members of society, and everyone will get food, clothing, housing, etc. because that is their right as members of society. From each according to his ability, to each according to his needs. During the Great Leap, most communes attempted to move a considerable distance towards this goal, though there was great variation between one commune and another. Most of the peasants' private plots were abolished. Most peasants were expected to do at least some work for which they were not paid. On the other hand, many communes simply gave food free to commune members without regard to how much work each family had done to earn that food. The Chinese later described this equal sharing of food, without regard to how much labour each family had done, as "eating out of one big pot".

The result of the G.L.F. however was a disaster. As the Leap went into 1959, administrative confusion deepened. The consequences of strain upon and misuse of resources, and of sheer human exhaustion, became increasingly serious. When the end came, it coincided with the withdrawal of Soviet assistance and a succession of natural

disasters. The results were appalling, the period of Fastest Growth ended in economic disaster.[15] Faced with economic collapse in the early 1960s, the government adopted some new policies to adjust and recover the economy. During the 1961-65 readjustment and recovery period, Chinese economy improved slowly but surely. By 1966 production in both agriculture and industry surpassed the GLF levels.

Thirdly, came the ten-year Great Proletarian Cultural Revolution (1966-76). When China's economy was on the path of stable development, China was again involved in political struggle. The long-term intraparty struggle over the imposition of a national political policy within the CCP themselves finally burst forth into the Cultural Revolution which began in 1966 and ended in 1976.[16] During that period, the people became all mad and crazy, and a mass struggle was brought about in the whole country. For a relatively backward country trying to modernise itself, such a revolution was a hideous disaster. It nearly destroyed the country as a whole. Its economy was seriously damaged. Industrial output decreased, imports of foreign equipment, required for technological advancement, were curtailed by violent anti-foreign outbreaks, and the growth of agricultural output was slow. The Cultural Revolution had important consequences for all aspects of life in China.

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[14] Randolph Barker and Radha Sinha, The Chinese Agricultural Economy, pp.72-73, Westview Press, boulder, Clorado Croom Helm. London, 1982.

[15] In 1960, output was only 74% of the year 1957, In 1960, 1961, and 1962, some areas of China tottered on the brink of famine, and starvation was only averted by using the country's foreign exchange reserves to import grain. See Frederica M. Burge, China - A Country Study, 1981.

[16] The Cultural Revolution was an attack by Mao on bureaucracy and the bourgeois influences among the intellectuals, and also a means of disposing of his rivals. In Mao's effort to expand his own personal cult and to dismantle the communist party hierarchy, an entirely new and unprecedented organisation, the Red Guards (who were all high school and university students) were invented. They exercised unchallenged and arbitrary authority over all institutions except the army. They attacked the offices and sometimes the persons of middle and high ranking communist party members accused of losing revolutionary diligence and of being soft bourgeois "capitalist roaders" and many of them were savaged to death. There was a general attack on intellectuals, the "stinking ninth category". All institutions of higher learning were closed due both to the struggles conducted against their administration and faculties and to the fact that the students were busy being Red Guards. The Cultural Revolution rapidly became a reign of terror. The Red Guards tried to smash old habits, old

2. Economic Reform and Open-door Policy in China since 1978

The deterioration in economic performance during the Cultural Revolution pointed to a need for some types of reform. The new leadership, under the direction of Deng Xiaoping, led the whole country into economic reform. Deng elevated the need for socialist construction based on Four Modernisations[17]. He thought that China was lamentably backward, and major reforms of the economy and administration were needed to raise production, and to get goods and products to the people. A policy of economic reform and opening the door to the outside world was announced in December 1978 at the Third Plenum of the Eleventh Congress of the CCP, which marked a watershed in the economic development of China. Since then, China has undertaken very drastic economic reforms, many of which are unprecedented in the history of socialist economic development. Specifically, wide international contacts were encouraged; the economic system has been transferred from centrally planned economy to market economy; and private ownership was established in many sectors and regions of China; and decentralisation of decision-making was actively implemented allowing local authorities to deal with such important matters as foreign trade, foreign investment and capital construction. As a result of the economic reform and the opening of the door to the outside world, China's economic growth has been dramatic, and its GDP has increased from RMB 451.8 billion in 1980 to RMB 8,205.4 billion in 1999.[18] The rapid growth of the economy and the establishment of the market economy created the necessary condition and environment for the development of China's insurance industry.

3. The Development of China's Insurance Industry

The origin of China's insurance industry can be traced back to more than 100 years ago, however the development of the industry was not significant until 1980. The experience of the world insurance industry demonstrates that the emergence and the

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customs, old ideas and old culture. Tradition would be thrown out in a wholesale manner as being reactionary.

[17] Modern industry, modern agriculture, modern national defence and modern science and technology.

development of the modern insurance industry are based on the development of productive forces and a commodity economy. In ancient China, its economy, as considered earlier, was primarily agrarian, in many ways it was a 'natural economy' or 'self-sufficiency' economy with a relatively low degree of commercialisation. Its insurance industry under that economic condition and environment was impossible to develop. Thus, the emergence and development of modern insurance in China lagged behind that of the developed countries. Modern insurance practice spread to China but not until the early 19th century.

3.1 The emergence of modern insurance in China

In the early 19th century, as Europe forged ahead through the industrial revolution, it became more powerful, and, in particular, the British began to expand their trade to China. As a result some modern insurance businesses, mainly in marine insurance, also appeared in China run by British businessmen. In 1805, some British businessmen who were managing business in China established an insurance company named the Canton Insurance Society in Canton which was the first insurance company set up by foreign merchants in China.[19] In the following years, several insurance companies were established by foreign businessmen in Shanghai.[20]

After the Opium War, foreign businessmen were allowed to do business freely in the treaty ports. Insurance was indispensable to a trade in rich cargoes - opium and treasure - and involving great risks - pirates, treacherous seas and periodic warfare. More British insurers established insurance companies and they made steady progress in China.[21] Before the 20th century, therefore, British insurance companies monopolised

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[18] The Statistical Bureau, Statistical Yearbook of China, 1999.

[19] Greeberg M., British Trade and the Opening of China 1800-1842, p.171, Cambridge, at the University Press, 1951.

[20] In 1808, the Atlas Insurance Company was set up by the British in Shanghai. In 1809, the British also established the North British and Mercantile Insurance Company in Shanghai, which mainly ran marine and fire insurance business. See PICC, *Jiefanqian waishange Baoxian Gongsi Zai Shanghai (The List of the Foreign Insurance Companies in Shanghai before 1949)*, Insurance Studies, No. 6, p.87. 1986.

[21] For example, the Union of Canton Insurance Company, which was established in 1835 in Hong Kong, bought some other small British insurance companies after the Opium War to expand itself. Before long it co-operated closely with the Commercial Union Insurance Company which was opened up in Shanghai in 1861 and the Insurance Department of Jardine Matheson & Co. (all of them were

the insurance market in China. From the early 20th century, the Americans, French, Germans, Swiss and Japanese established their insurance companies or insurance agencies in China one after the other.[22] During that time, foreign insurance companies were monopolising China's insurance market. All insurance clauses, policies or premium rates were enacted by foreign underwriters.

3.2 The formation of China's national insurance industry

The practice of transacting insurance business by Chinese people themselves can be traced back to 1875. The emergence of China's national insurance was not only a consequence of the needs of the development of the national economy but also the outcome of stimulation and crowding out by foreign insurance companies. From the early 19th century, China's traditional agricultural economy had begun to break down. There had been few significant innovations with respect to agriculture. Small peasant farms were clustered in isolated villages and communication among them occurred with relatively independent marketing areas. Towns and cities were commercial hubs, conduits for rural food and grain, and intellectual and political centres. Especially after western powers' incursions into China, foreign merchants could do considerable business there. Further, some Chinese businessmen did business with them. Thus China's commerce began to develop in such a way as to establish the conditions for the emergence of a national insurance industry.

In a sense, the stimulation resulting from the invasion of foreign powers was the direct

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managed by British businessmen) to form an Insurance Monopoly Bloc in the Far East. In 1863 British businessmen opened up the British & Foreign Marine Insurance Company in Shanghai which transacted marine and fire insurance business. In 1865, the British Traders Insurance Company was established by the British in Hong Kong which transacted mainly marine and fire insurance business. In 1866, the Hong Kong Fire Insurance Company was set up by Jardine Matheson & Co. See Shi Zheming, *Jiefangqian Zhengguo Baoxian Fazhan Qingkuang (The Development of China's Insurance before 1949)*, Insurance Studies, No. 1, p.59, 1983.

[22] American businessmen established the Alliance of Philadelphia Insurance Company in Shanghai in 1905 trading in marine, fire and automobile insurance business. In 1921 the Asia Life Assurance Company was formed in Shanghai by Americans to operate life assurance business. In 1918 French businessmen set up the Assurance Franco-Asiatique Insurance Company in Shanghai. Most foreign insurance companies based their head offices in Shanghai, and had branches in every big city along the coast, railway stations and the Yangtse River. See PICC, *Jiefangqian Shanghai de Waishang Baoxian Gongsi (The List of Foreign Insurance Companies in Shanghai before 1949)*, Insurance Studies, No. 6, p.87, Beijing, China, 1986.

reason for the emergence of China's national modern insurance. After foreign powers intruded into China, they at first occupied the transportation of the sea and the inland waterways. This led to a drastic decline of China's water transport industry and ship-building industry. Under these circumstances, the Steamship Commerce Bureau of China (Lun Chuan Zhao Shang Ju) was established in 1872. It bought three ships from foreign ship companies and the ships had to be insured by foreign insurance companies because there were no Chinese insurance companies then. The foreign insurance companies and foreign ship companies attempted to strangle the Chinese shipping industry. They refused to provide insurance for the Steamship Commerce Bureau or charged high premiums. The difficulty of securing insurance for ships made some leaders of Qing Dynasty like Li Hongzhang[23] recognise the significance of setting up insurance by Chinese themselves. On 28 December 1875, China's first National Insurance Institute - the Insurance Bureau of Commerce (*Baoxian Zhaoshangju*) - was formally established, which altered the situation whereby foreign insurance companies had been monopolising China's insurance market. It was the beginning of China's national modern insurance industry.[24] To meet the needs of the expanding transport business, the Steamship Commerce Bureau set up another insurance institution in 1878 - the Ji He Insurance Company. In 1886, two insurance companies - the Ren He and the Ji He were merged into one - the Ren Ji He Insurance Company.[25]

3.3 The growth of China's insurance industry before the foundation of the People's Republic of China (Pre-1949)

Following the foundation of the Ren Ji He Insurance Company, a number of other Chinese national insurance companies were set up in the late 19th century[26] and early

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[23] He was the most powerful leader of the regional armies of the Qing Dynasty in the late 19th century. He was one of the successful supporters of Chinese industrialization and commercialization. He also advocated learning from the western countries and took a large part of the responsibility for conducting China's foreign relations.

[24] Wu Yue and *Cao Xuguang, Woguo Diyijia Baoxian Qiye Mingcheng he Chengli Nianyuo de Kaozheng (The Texstual Criticism of the Name and Time for the First Chinese National Insurance Company)*, Insurance Studies. No. 6, p.40. Beijing, China, 1983.

[25] Wu Yue and Du Boru. *Guanyu Ren He, Ji He Baoxian Gongsi de Chazheng (The Textual Criticism about Ren He, Ji He and Ren Ji He Insurance Companies*), Shanghai Insurance, No. 1, p.31, 1990.

[26] They were: An Tai Insurance Company (1877), Chang An Insurance Company (1880), Shanghai Fire Insurance Company (1882), and Wan An Insurance Company (1882). However, these companies were closed soon after opening up because they had no insurance experience and insufficient funds.

20th century[27], they all transacted property insurance business. In 1912, the first Chinese life insurance company - the Hua An He Qun Life Insurance Company was established in Shanghai. China's insurance industry made little progress until the 1920s. When GMD came into power, China's economy began to recover. China's national industry, commerce and banking developed rapidly which created favourable conditions for the growth of the national insurance industry. During the 1920s and 1930s, two significant changes appeared in China's insurance market. First, after 1926, banks' capital was invested in China's insurance.[28] Secondly, from 1935, GMD bureaucratic capital (GMD government officials' capital) penetrated the insurance market.[29] Both brought about great development in China's insurance industry.

The investment of GMD bureaucratic capital promoted the growth of China's national insurance industry. Some companies whose head offices were in Shanghai began to set up branches in interior cities. Some which had been run with bank capital appointed

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[27] Such as Hong Kong Chinese Businessmen Yuan An Insurance Company (1904), Hua Wing Insurance Company (1905), Tong Yi and Wuan Feng Insurance Companies (1905), and, in 1908, China Win Yi, Yi An, Hong An, Pu Hua, Yi Tong Ren, Hong Shen and Hu Tong Insurance Companies were opened up. In 1909, Tong An Insurance Company was set up. All of them transacted property insurance.

[28] In December 1926, Bank of Communication, Jin Cheng Bank, Zhong Nan Bank, Da Lu Bank, Guo Hua Bank and Dong Lai Bank jointly set up An Ping Insurance Company. In March 1927, Shanghai Commercial Savings Bank created Da Hua Insurance Company. In Nov. 1929, Jin Cheng Bank established Tai Ping Marine and Fire Insurance Company in Shanghai. On 1 Nov. 1931, Bank of China (it was founded in 1904 and was a powerful semi-official bank under the GMD) invested capital to set up China Insurance Company in Shanghai, which was one of the biggest among the national insurance companies at that time. It had agencies all over the country. Owing to the swift expansion of the business, China Insurance Company could do reinsurance some business with foreign insurance companies. See Tang Mingzhi, *Jiefangqian Zhongguo Baoxian Gongsi Zaibaoxian Yewu de Huigu (The Recollection of the Reinsurance Business of Chinese Insurance Company before 1949)*, Shanghai Insurance, No.5, p.36, Shanghai, China, 1991.

[29] In order to seize control over national finance, the GMD government had attempted since 1927 to strengthen the national financial institutions. In 1928, the GMD government reorganised the Central Bank of China which was established in 1924, acting as proxy for the State Treasury, with the right to issue currency and mint coins and to handle domestic and foreign debts. Soon after this the government took over two big private indigenous banks – the Bank of China and the Bank of Communications. After dominating the banking system, the GMD government began from 1935 to seize control of China's national insurance industry, *e.g.* in 1925, the Central Bureau of Trust set up an insurance section in Shanghai. However, the control of these financial institutions was actually in the hands of the "Four Biggest Families" of China, namely the Chiang, Song, Kong and Chen Families, who provided officials for the GMD government. The GMD government officials (*i.e.* ministers and civil servants) invested their private moneys to insurance companies for their own gain. This was allowed by the GMD government. See Shi Zheming, *Jiefangqian Zhongguo Baoxian Fazhan Qingkuang (the Development of China's Insurance Industry before 1949)*, Insurance Studies, No. 1, p.61. 1983. See also H. H. Frank, A Concise Economic History of Modern China (1840-1961), pp.116-122, Pall Mall Press. Britain, 1969.

their insurance agencies in interior cities through bank branches in those cities. Some big private companies like the China Insurance Company and the Tai Ping Insurance Company were expanding their business abroad. By 1937, there were 40 Chinese national insurance companies, of which 2 were state-owned and 38 were Chinese private companies, and 166 foreign insurance companies (from 16 countries)[30] It was clear that foreign insurance companies still largely dominated insurance business in China.

Facing sharp competition from foreign insurance companies, the Chinese national insurance industry struggled hard to expand its business. However, during the eight years of the Sino-Japanese War (1937-45), like other Chinese industries, China's insurance industry was nearly ruined. After the Sino-Japanese War, Shanghai again became the centre of the insurance market. Foreign insurance companies which were closed down in war time re-opened business in Shanghai after the War. In addition, due to the GMD government's inflation policies, the currency depreciated daily creating chaos in the financial markets. Many speculative insurance companies were suddenly set up by some businessmen. The number of companies increased to 238 in Shanghai which included 63 foreign and 175 Chinese insurance companies.[31] Due to the intense competition and violent inflation, lots of Chinese national insurance companies were forced to stop business. On the eve of the establishment of the People's Republic of China, a third of Chinese insurance companies closed down, only 126 of 175 were able to survive.[32]

3.4 After the foundation of the PRC (Post-1949)

Before 1949, insurance companies in China fell into three main categories: foreign insurance companies, GMD bureaucratic capitalists' insurance companies[33] and Chinese

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[30] Shi Zheming, *Jiefangqian Zhongguo Baoxian Fazhan Qingkuang (the Development of China's Insurance Industry before 1949)*, Insurance Studies, No. 1, p. 61, Beijing, China, 1983.
[31] Liao Shen, *Kangri Zhanzhenghou de Shanghai Baoxianye (The Insurance Industry in Shanghai after Sino-Japanese War*), Shanghai Insurance, No.12, p.45, Shanghai, China, 1992.
[32] *Ibid*, p.48.
[33] See note 29 *supra*.

private companies. After 1949, the CCP employed three major means to transform the old insurance market.

a. Taking over or confiscating companies owned by the GMD bureaucratic capitalists;[34]

b. Abolition of foreign insurance company's privileges and concessions[35];

c. Socialist transformation of Chinese private insurance companies.[36]

At the same time as China's old insurance market was being transformed, a new type of socialist insurance system was formed. In October 1949, the People's Insurance Company of China (hereinafter PICC), a united, centrally controlled and state-owned insurance company was founded by the People's Bank of China (PBC) with its head office in Beijing. The PICC expanded rapidly; by the middle of 1950, it founded branches and sub-branches in every province.[37] During the period of the rehabilitation of China's economy, 1950-52, the PICC grew greatly in terms of its scope, number of employees and volume of business. During that period, the PICC mainly transacted compulsory insurance for state-owned units and enterprises according to the orders of the government. In urban area, the PICC transacted fire insurance, life insurance, transportation insurance, automobile insurance. In rural area, the PICC also offered crop insurance, animal insurance, cotton harvest insurance. It also transacted export

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[34] By the end of 1949, among the 126 Chinese insurance companies, 23 were owned by the GMD bureaucrats, of which 21 were taken over by the new government in 1949, and only 2 were allowed to carry on business under government supervision. See Shi Zheming, *Jiefanghou Zhongguo Baoxian Fazhang Qingkuang (The Development of Chinese Insurance after 1949),* Insurance Studies, No. 2, p.56, Beijing, China, 1983.

[35] In 1949, there were 41 foreign insurance companies in Shanghai. In order to protect China's national insurance industry, the government imposed various restrictions on foreign insurance companies and competed with them to gradually cut down the sources of their insurance and reinsurance business. By the end of 1952, all foreign insurance companies had been forced to stop their insurance business in China.

[36] Towards Chinese private companies, the CCP pursued a policy of utilisation, restriction and transformation to protect them and to encourage them to amalgamate under the supervision of the government. These companies also underwent a socialist transformation. The government organised 47 private companies in Shanghai and Tianjin to set up the Mass Union of Reinsurance Exchange. Later the Mass Union was reorganised into two state-private-owned companies (with both the state's and individuals' shares). One was the Tai Ping Insurance Company set up in 1951, the other was the Xin Feng Insurance Company established in 1952. These two companies were merged into one in 1956 named the Tai Ping Insurance Company, which soon moved from Shanghai to Beijing, closing its domestic branches and retaining its overseas branches in Manila, Jakarta, Saigon and Singapore. The combination of Tai Ping and Xin Feng insurance companies marked the end of the socialist transformation of China's old insurance market and the beginning of a new type of socialist insurance system. See the report of the President Lin Zhen Feng about the amalgamation of Shanghai private insurance companies. December 1951, Beijing; and The PICC's report on the establishment of the two companies - *the Tai Ping and Xin Feng Insurance Companies*, the PICC 1952, Beijing, China.

and import of goods, ocean marine cargo transportation insurance and war risks. By the end of 1952, it had about 1300 branches and sub-branches all over the country with over 40,000 employees and 3000 agencies.[38]

The PICC's expansion, however, was too rapid and in some ways it did not conform to the actual needs of the people in urban and rural areas during a period in which the country's economy was recovering from war. Paying the insurance premiums was a heavy burden on enterprises, especially for peasants. Under this circumstance, the PICC adopted some steps to readjust, to reduce its business and to rationalise its institutions and the numbers of its employees.

During the period of the GLF and the People's Commune, the People's Commune led directly to a cessation of domestic insurance business. It was thought that China had achieved communism, and all property belonged to the state and commune, therefore everybody had a right to share the commune's property. Thus, even if some catastrophe or accident happened, the state and commune would give emergency assistance to, or appropriate a sum of money to, the unit or the people who suffered loss or damage. So it was believed that the role of insurance had already disappeared and domestic insurance business should be stopped immediately.[39] It was decided at the Seventh National Insurance Meeting in January 1959 to stop the domestic insurance business. Soon after, apart from limited foreign related insurance business, most branches of the PICC, except Shanghai, Guangzhou and Harbin, stopped domestic insurance.[40] During the ten years Cultural Revolution (1966-76), the domestic business

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[37] The statistical report of the PICC of 1950, PICC, Beijing, China

[38] The Insurance Institute of China. *Shiqinian Lai de Guojia Baoxian Dashiji 1949-66 (The Record of the Important Events of China's Insurance during 1949-66*). Bao Xian Wen Xuan (Selected Insurance Articles), p.108, 1982.

[39] In 1958, at the National Financial Meeting, it was decided that "with the appearance of the People's Commune, the role of insurance does not exist any more, domestic insurance business should stop immediately and only small foreign insurance business would be retained."

[40] Shanghai, Guangzhou and Harbin maintained some domestic business until 1966. For the reasons why these three cities could maintain their insurance business for a longer time, see Jing's M.Phil Thesis (my own thesis) "The History and the Future of China's Insurance Industry", pp.118-127. This thesis was submitted for the degree of Master of Philosophy in the University of Wales.

ceased completely, and the small amount of foreign related insurance business almost ceased.[41]

The existence of a highly centrally planned economy eliminated the objective basis for the existence and development of the national insurance industry. The history of the world insurance industry shows that the emergence and the development of the modern insurance industry are based on the economic fortunes of a commodity market economy. However, China's insurance industry had since its beginning lacked such an economic environment. It was, after all, born and developed in the circumstances of a centrally planned economy. This hampered the development of China's national insurance industry.

3.5 The recovery and development of China's insurance industry since 1980

3.5.1 The reopening and the rapid development of the PICC's insurance business (1980-1990)

Economic reforms and the open-door policy promoted the development of China's insurance industry and revived its domestic insurance. Since the economic reform, China's economic system has changed from a centrally planned economy to a market economy. China's economy has been developed dramatically. Such an economic environment provided favourable conditions for the existence and the development of China's insurance industry. In 1980, the PICC reinstated domestic insurance under the instructions of State Council's Document of 1979 No. 99.[42] Since then China's insurance industry has been growing at an unbelievable rate.

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[41] See Jiang Yunting, *Whenge Qijian Shewai Baoxian Yewuzu Gongzuo Qingkuang de Huiyi Pianduan (The Recollection of a Foreign Related Insurance Business Group during the Cultural Revolution),* Insurance Studies. No. 3, pp.16-18, Beijing, China, 1989.

[42] In April 1979, the State Council issued the document 1979 No. 99, in which it was stated that the PICC was to run an insurance business to accumulate funds for the state and to provide economic compensation for state and collective properties. From then on, all imported equipment would be covered by insurance. The profit secured by the insurance companies would not be handed over to the Ministry of Finance, but would remain with the companies themselves as an insurance reserve in order to enable the enterprises and the peasants to get indemnity immediately when they suffered losses or damages from accidents or natural calamities, and the PICC was to reinstate domestic insurance business step by step after experiments and set up branches in every province, municipality and

At first, when domestic insurance business was reinstated, the PICC mainly transacted property insurance business.[43] Enterprise property insurance occupied a dominant position before 1986. After 1986, vehicle insurance became the most important class of domestic insurance. At the same time, household property insurance business and goods transport insurance were also expanding rapidly between 1980 and 1985.[44] From 1982, when life assurance and agricultural insurance began to be opened up, the percentage of property insurance in the total domestic business began to decline. Following the great development of the economy, people's living standards had been greatly improved, so people were increasingly thinking about life insurance. The pace of growth of life insurance was very fast at an average rate of 554.2 per cent per year between 1982 and 1985. However, the growth of life insurance declined with the influence of the high inflation which happened between 1987 and 1989. From 1988 to 1991, the growth rate of life insurance was 35.67 per cent.[45]

Economic reform and the open-door policy expanded the PICC's existing foreign related insurance business.[46] Meanwhile its international inward reinsurance business continued to expand. In order to meet the needs of the rapid expansion of economic relations and technical co-operation with other countries and diversified forms of foreign trade, the PICC made big progress in exploiting the new types of coverage of foreign related insurance business.[47] Along with the increase of new types of coverage,

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autonomous region and some cities. All branches should be under the control of the PICC and the PBC. PICC should play a dominant role in running business.

[43] Between 1980 and 1981, almost 100 per cent of domestic insurance business was property insurance (it included enterprise property insurance 97 per cent, household property insurance 0.0024 per cent, vehicle insurance 2.71 per cent, cargo transportation insurance 0.017 per cent and others 0.18 per cent of the total premium from domestic property insurance). See Li Jiahua and the PICC group, Zhongguo Baoxian de Fazhan (The Development of China's Insurance Industry), p.150, 1990.

[44] During 1980 to 1985, the growth rate of different type of property insurance were: enterprise property insurance, 30%; vehicle insurance, 196.46%; household property insurance, 983% and transportation insurance, 202.64%. See the PICC's Statistical Yearbooks, various issues, the PICC, Beijing, China.

[45] *Ibid.*

[46] In 1979, the PICC made satisfactory progress in its foreign related insurance business. Overall premium income from its direct underwriting amounted to RMB171.16 million, a 24.84% increase over the previous year. See the PICC's Annual Report for 1979, reported by the General President Song Guohua in September 1980, Beijing, China.

[47] For instance, in 1984, the PICC signed insurance contracts with 23 oil companies owned by 12 oil exploration groups in 7 countries to cover property, comprehensive third party liability, blowing out, oil pollution, cargo transportation and all risks, in respect of drilling and supply ships, labour and

the structure of foreign insurance business was changing. The percentage of the traditional type of cargo transportation insurance in foreign business was decreasing year by year, 90 per cent in the 1960s, 68 per cent in 1981 and only 52 per cent in 1988.[48] Other coverages such as non-marine insurance, oil exploration insurance, marine hull insurance, aviation insurance and projects contracted for abroad, as well as satellite-launch insurance became increasingly important.[49] With regard to the reinsurance business, the PICC continued to build up links with counterparts in foreign countries and regions throughout the world. By the end of 1990, the PICC maintained business relationships with all the leading insurance and reinsurance companies and broker firms all over the world.[50] The number of the PICC's overseas insurance offices has expanded rapidly too. Since 1980, the PICC has established insurance offices in Western Europe, America, Canada and Japan in addition to ones in Hong Kong, Singapore and Macao. By the end of 1990, the PICC's overseas offices had risen to 60 from 11 in 1979. The number of employees working in overseas offices rose from 388 in 1979 to more than 800 in 1990.

In general, the PICC has been growing quickly since 1980, especially in the early years between 1980 and 1985, the domestic insurance business grew at an average rate of 55.06 per cent *per annum*. This pace of growth was unprecedented in China's insurance history and world insurance history. Although the growth rate of the domestic business has been getting slower since 1985, the average rate was still 31.29 per cent per annum from 1986 to 1991.[51] By the end of 1991, PICC had over 3000 branches and sub-branches with nearly 90,000 personnel. The types of coverage

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employer's liability. There was also coverage of property, data processing, cash, cargo transportation, motor vehicle and employee's fidelity. Also machinery breakdown, loss of profit, travellers' liability and employer's liability have been extended to Sino-foreign joint ventures and cooperative enterprises. See PICC's annual report for 1984, reported by the PICC's President Qin Daofu in 1985, Beijing, China.

[48] Foreign-related insurance, published by the PICC in 1990, Beijing, China.

[49] The classes of foreign-related insurance undertaken by the PICC increase from 20 in 1980 to 90 in 1990. By the end of 1990, the PICC was virtually able to provide all types of foreign insurance obtainable in the international insurance market. The premium income for foreign insurance business reached US$438 million in 1990, an increase of US$338 million over 1980 when it was US$100 million. See the PICC's Annual Report of 1990, Beijing, China.

[50] Foreign-related insurance, published by the PICC in 1990, Beijing, China.

[51] The PICC's Year Report and Accounting, 1985 and 1992, Beijing, China.

available reached nearly 400, of which more than 300 types were domestic insurance coverage and more than 80 types were foreign insurance coverage.[52]

3.5.2 The expansion and competition of China's insurance market since the end of the 1980s

Following the economic reform and the growth of the insurance industry, China's insurance market has changed greatly. Before 1986, the PICC was the only insurance company and had monopolised China's insurance market. Since 1986, more and more companies have been set up, the monopolistic system broken down, and competition has been introduced in China's insurance market. In 1986, the Agriculture and Animal Husbandry Insurance Company was established by the Productive Construction Army Crops in Xinjiang autonomous region. In May 1988, the Pingan Insurance Company was established in Shenzhen special economic zone. Its branches soon spread to every city in the country.[53] In 1988, the Communication Bank of China set up an insurance department in Shanghai which was reorganised into the Pacific Insurance Company in 1990 with its head office in Shanghai and branches in provinces countrywide.

Under the open-door policy, foreign insurance companies were also allowed to enter China's insurance market. Since 1988, many foreign insurance companies have opened up liaison offices in China. After 1992, when Deng Xiaoping visited the South of China, the Government has speeded up the opening up of insurance market. In November 1992, the American International Assurance Co., Ltd (AIA) set up a branch in Shanghai which was the first foreign insurance company to open insurance business in China since 1980.[54] Later, more foreign insurance branches and business offices have been permitted to set up. New insurance companies have been established continuously. By the end of 1999 there were 30 insurance companies in China, of

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[52] The PICC's Statistical Book of 1991, PICC, Beijing, China.

[53] This company is a joint-stock insurance company invested in by the Bureau of Commerce Shekou Industrial District Authority and the Shenzhen Credit and Investment Corporation of the Industrial and Commercial Bank of China.

[54] Lin Zengyu, *Zhongguo Baoxian Shichang de Fazhan Yu Qianli (The Potential of China's Insurance Market)*, Insurance Studies, No.1, p.7, Beijing, China, 1996.

which 13 were China's national insurance companies and 17 were foreign insurance companies.[55] According to the statistics, by the end of 1999, 113 foreign insurance companies of 17 countries and regions set up 202 business liaisons in China. Chinese insurance companies set up 33 insurance institutes and 8 agencies in Asia, Europe and North America.[56] Recently, a new type of insurance company - the joint venture insurance company has been permitted to set up in the Chinese insurance market.[57] Following the increase of the insurance companies, the premiums increase greatly. By the end of 1999, the premiums of all over the country was RMB 193.32 billion.[58]

3.5.3 The reasons why China's insurance industry has been developing so quickly since 1980s

The development of the market economy created the need for a rapid growth of China's insurance industry. The formation and the development of modern insurance activities have been based on the emergence and the growth of a market economy. The development of the market economy has meant that the scope and scale of commodity exchange have expanded and trade patterns have diversified. Under these circumstances, risks were increased in the process of exchange and production of commodities. It was inevitable that insurance, which has the function of spreading risks and compensating for economic losses, would be necessary in these circumstances. In order to avoid the interruption and the stagnation of economic activity as a result of an accident or natural calamity, commodity producers and traders needed the protection of insurance. In addition, under a market economy, there were independent economic entities possessing different economic interests. In order to ensure the safety of their respective economic interests, they had to have something which would give them security. Since 1978, China has begun to transfer from a centrally planned economy to

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[55] See the statistics. China Insurance, No. 2, p. 5, Beijing, China, 2000.

[56] See Ma Yongwei, The chairman of the China Insurance Regulatory Commission, Baoxian Zhishi Duben (The Book of Insurance Knowledge), p.2, China Banking Press, 2000. See also Insurance Research Letter, Far East – 3, Sep. 1999.

[57] On April 7, 2000 the Prudential Plc (UK) and China International Trust and Investment Corporation (CITIC) formally announced the establishment of the first Sino-British joint-venture life insurance company in China. The two companies will each hold 50% of the rights and interests of the joint-venture. It was reported on the Xianggang Da Gong Bao (Hong Kong Ta Kung Bao) April 6, 2000.

a market economy which has provided the essential conditions and environment for the development of China's insurance industry. Especially when Deng Xiaoping visited Southern China in 1992 he worked hard to promote economic reforms and in particular the establishment of a market economy with socialist characteristics. Since then China's insurance industry has been growing more strongly and the insurance market has been expanding more quickly.

On the other hand, following the development of China's economy, people's living standards have been largely improved and people can afford to buy insurance. The improvement of people's living standards is unbelievable as compared with its previous level. Before the economic reform, Chinese poor income could only cope with a basic living need for food, clothing and shabby housing, so how could they afford to buy insurance? Since 1978, the economic reform has brought about rapid growth of China's economy which greatly changed people's living standards. Now in some cities of China, citizens' living standards is not so different from that of some developed countries. In China's countryside, peasants' incomes have greatly increased and they are getting richer and richer. A large number of peasants have not undertaken farm work but have been engaged in non-farm work. Agriculture, industry, transportation and commerce have all developed rapidly in rural areas. Consequently, peasants' living standards also have been improved dramatically. Therefore they can afford to take out insurance.

Moreover, due to the change of Chinese society, people are forced to think about insurance. First, pension policy changed. Under the previous pension policy the state provided the basic living securities (including pension and medical treatment) for all the staffs of the state-owned entities, government personnel and factories' workers after their retirement. After the economic reform, the socialist market economy has been gradually establishing and correspondingly the structure of the enterprises has been reformed. The previous pension policy could no longer suit the new situations. In order to accommodate the interests of the state, enterprises and individuals, the State Council enacted the Decision on the Enterprises Employees' Pension Security System

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[58] See note. 56, *supra*.

Reform in 1991[59] in which a new method for pension insurance was introduced, namely, to combine the basic pension insurance with the supplementary enterprise pension insurance and individual pension insurance to establish a pension insurance system for enterprises' employees, the premium would be paid by the state, enterprise and individual.[60] In the same vein, the government undertook the medical treatment system reform by adopting the social insurance on medical treatment under which the enterprise and employee jointly pay the premium instead of the old system by which the state and the enterprise cover the whole expenses for the employees' medical treatment.[61] The Labour Law 1994 (PRC)[62] made all kinds of social insurance compulsory.[63] However, according to these laws and regulations, social insurance provides only a basic living security for only the employees of the state-owned and collective enterprises. A large number of the peasants[64] are still left uncovered by social insurance; they have to take out commercial insurance[65] by themselves for their old age life and medical treatment.

In addition, the single child policy is another important element that facilitates the rapid growth of life insurance in China. One couple is allowed to have only one child under

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[59] It was enacted by the State Council on 26 June 1991.

[60] The new system is practised at three levels. First, basic pension insurance provides the basic living needs for all retired workers which is a compulsory insurance, the premium is paid jointly by the state, enterprises and the individual. Secondly, supplementary enterprise pension insurance is offered subject to the enterprise's particular situation, if the enterprise has a good profit, it can take out pension insurances for its workers. Thirdly, the individual employees are encouraged to take out pension insurance on voluntary basis.

[61] See the Notice of the System Reform Committee, the Financial Ministry, the Labour Ministry and the Health Ministry on the "Suggestions on the Reform of the Employee Medical Treatment System", which was issued on 14 April 1994.

[62] It was adopted at the 8th Session of the Standing Committee of the 8th National People's Congress on 5 July 1994 and effective as of 1 Jan. 1995.

[63] In art. 72, It is stated: "The sources of social insurance funds shall be determined according to the branches of insurance, and an overall raising of social insurance funds shall be practised step by step. The employing unit and labourers must participate in social insurance and pay social insurance premiums in accordance with the law."

[64] According to the latest Chinese nation-wide census which happened in Nov. 2000, the percentage of the population in rural areas accounts for 63.91% of the whole population in China.

[65] It needs to be explained that in China the term "commercial insurance" is opposite to the term "social insurance". All business transacted by insurance companies is classified to commercial insurance in China. social insurance is organised by the government, while in England, the term "commercial insurance" is opposed to the term "individual insurance", its "national insurance" is similar to Chinese "social insurance".

the policy.[66] The nation-wide birth control campaign through various incentives and penalties was launched in 1980. These efforts have met with some success, especially in the overcrowded urban areas. Now the typical style of Chinese family is one couple with one child. However, another serious problem arises, *i.e.* the rapid growth of the old population. With the improvement of medical services and the practice of family planning, life expectancy becomes longer than ever and the percentage of old people in the whole population is becoming larger in China.[67] There is no doubt that this rapid increase of the percentage of old people will influence many aspects of the society, such as pension, welfare and medical treatment, etc. It is the Chinese tradition and law[68] that sons or daughters have the responsibility to provide allowances for their elderly parents. Thus, in the near future, it will be a heavy burden for a young couple to support four elderly parents financially, in particular in rural areas where the elderly people have no pension at all. So pension insurance and medicine insurance have become popular in China.

These are the main reasons why China's insurance industry has developed so quickly and steadily since 1980. Although the insurance industry has grown so fast, as shown in Table 1, the percentages of premium income to the GDP and premium income on the *per capita* basis are still very low, thus the potential for the further development of insurance industry in China is still very large.

The rapid development of China's insurance industry and the swift expansion of the insurance market have increased the need for further legislation of insurance law.

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[66] This policy is not so strict to peasants. If a peasant couple have a girl first, they are allowed to have the second child.

[67] In China, the percentage of the old population has been increasing since the implementing of the single child policy. According to the third nation-wide census in 1982, the percentage of people aged 65 and over was 4.9% of the total population, in 1990 the fourth nation-wide census showed that the percentage of old people was 5.57% and it increased to 6.96% at the end of 2000 in accordance with the fifth nation-wide census. See http://www.snweb.com/gb/people-daily/2001/03/ 29/a0329001.htm. It is predicted that by the year 2020, the percentage will be 11.5% and be 22.6% in 2050. See United Nation: World Population Prospects and China Population Prospects, the 1998 Revision. For the detailed discussion about the old age population, see Tian Xueyuan, *Renkou Laolinghua Yu Ke Chixu Fazhang (The percentage of old population is getting higher)*, Zhongguo Renkou Ziyuan Yu Huanjing (China Population, Resources and Environment), No. 1, p. 64, 2001.

[68] See the Marriage Law of the PRC which was enacted in Sept. 1980.

Table 1 The GDP of China, total premium income of the whole insurance industry, the percentages of premium income in the GDP and the premium income *per capita* from 1980 to 1998 (£1=RMB 13)

Year	GDP (RMB billion)	Premium income (RMB billion)	Premium /GDP (%)	Premium *per capita* (RMB, 1)
1980	451.8	0.46	0.10	0.47
1981	486.2	0.78	0.16	0.78
1982	529.5	1.03	0.20	1.01
1983	593.5	1.32	0.22	1.29
1984	717.1	2.00	0.28	1.93
1985	896.4	3.31	0.37	3.17
1986	1020.2	4.58	0.45	4.33
1987	1196.3	7.10	0.59	6.62
1988	1492.8	10.95	0.73	10.05
1989	1690.9	14.26	0.84	12.89
1990	1854.8	17.85	0.96	15.76
1991	2161.8	23.97	1.11	20.93
1992	2663.8	37.80	1.42	32.71
1993	3463.4	52.50	1.52	45.03
1994	4675.9	63.00	1.35	52.57
1995	5847.8	68.30	1.17	56.39
1996	6788.5	77.60	1.14	63.40
1997	7477.4	108.00	1.44	87.36
1998	7955.3	124.73	1.57	100.89

(Sources: Statistical Yearbook of China 1998, Population Statistical Yearbook of China 1998)

4. Brief Introduction of Chinese Legal System

4.1 Traditional underpinnings of Chinese law

In China, two major philosophical traditions oppose and interact with each other in Chinese Jurisprudence: Confucianism and Legalist thought. These philosophical views have strongly influenced the Chinese way of life and its legal development. The influence has permeated the whole of Chinese history. The essence of Confucianism is the belief that desirable behaviour and societal harmony can be obtained by the rule of good men, whose virtuous examples are the most effective form of persuasion, but not by strict regulation or severe punishment. Confucianism stresses the virtue of yielding and compromise so as to avoid friction. It also emphasises an ideal universe of

harmony in which nature and human society assume their proper places and in which virtue and propriety in ruler and ruled follow traditional, hierarchical pathways. Each person fulfils a preordained and class based function in society and is collectively responsible with others in reforming bad behaviour through willed social conformity. Confucianism is basically a philosophy of harmony, peace and conciliation. In contrast, the Legalist tradition insists that society can achieve harmony only by using strict and firm punishment on transgressions. The Legalists argued that human beings are fundamentally amoral, and that they cannot be moved by moral example. The only way to make them behave correctly is by a strong legal system, which enforces correct behaviour through rewards and punishments. If even minor infractions are ruthlessly punished, then nobody will dare to commit serious crimes. The Legalists stress state power and control rather than morality. They think only the enforcement of the powerful and forceful written law could curb crime and keep society in order.

By reflection of these philosophical senses in law, the purpose of law in China is basically, and has always been, twofold. On the one hand, the authorities have tried to make the enforcement of law flexible and adaptable to circumstances. Education, mediation and the reform of offenders have always played a great role and do so still today. This can be seen as a continuation of Confucian ideas. On the other, law is and has always been also regarded as a deterrent and is used to suppress offenders. This is in conformity with Legalist thinking. The model behaviour (*Li*) central to Confucian legality and the written law (*Fa*) of the Legalists have existed side by side, although the Confucian has more influence throughout Chinese history.[69] So the Chinese legal system and laws have been characterised by having two sides, namely, to reform the offenders by education and mediation on the one hand and to punish them on the other.

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[69] Confucians philosophised that: If the people are guided by *Fa*, and order among them is enforced by means of punishment, they will try to evade punishment and have no sense of shame, but if they are guided by virtue, and order among them is enforced by *Li*, they will have a sense of shame and also be reformed. The dominance of *Li* over *Fa* has continued from imperial China through the GMD era and to the PRC. For example, in the 1982 Chinese Constitution, the concepts of *Li* was reflected. (The Constitution of the PRC adopted by the 5th session of the 5th National People's Congress on Dec. 4, 1982, and was amended in 1988, 1993 and 1999). Art. 111 of the Constitution stipulates that neighbourhood and municipal people's mediation committees are established.

4.2 A brief overview of the legal system of the PRC

The establishment of the PRC marked the beginning of a new era in China in which it began to develop its polity and economy independently and it was the beginning of a new stage in Chinese legal history. Chinese Communist Party's aim, since its origin, has been to establish a fully socialist society in China. Having decided to abolish totally the legal system of its predecessors, the PRC government set itself the difficult task of establishing a whole new legal system, which had to be both socialistic and Chinese. During the period of 1949 to 1966, the Chinese legal system experienced difficulties at various stages of its development, but made considerable overall progress towards these goals. The government made active use of legal instruments to achieve this political goal of socialist construction. However, during the Great Proletarian Cultural Revolution (1966-1976), Chinese legal systems accompanied by other "bourgeois traditional institutions" were nearly uprooted. One of the most popular slogans was "smash the security bureau, procuratorial system and judicial system (*Zalan Gong Jian Fa*)". The implementation of this slogan resulted in the collapse of judicial and legislative systems. With law schools closing down, the lawyers and law teachers as well as legal scholars and judges were removed from their positions and sent to farms for "re-education". While there was no additional statute law, other existing codified laws were either suspended or declared void - even the Constitution suffered the same fate. Chairman Mao's words prevailed over all laws, even some official's instruction also functioned as the law, and in many cases there was simply no law to go by.

The situation did not change until the end of the Cultural Revolution and pragmatic policies were adopted by the Chinese government in 1978 when the government announced that the country would, from then on, concentrate its efforts on economic construction. The new economic policy, with its more decentralised governmental control and growing independence for individual economic entities, has greatly complicated economic relations. There is thus a pressing need for new laws and regulations governing economic activities. The Chinese legal system and law have been re-established since 1979. Many of the current laws and regulations are directly rooted in the economic reform. The government paid great attention to legislation on economic matters. Of the laws enacted since 1979, most deal with economic matters.

The government has extensively resorted to such legal instruments to ensure the success of its reform policies. Indeed, most of the new economic policies are reflected in one way or another in existing laws and regulations. The economic reforms have also increased the need for developing the legal system to match changing economic relationships, and to provide basic guidelines for the economic activities of Chinese businesses which are now no longer as tightly controlled by the state. Chinese laws and regulations have developed rapidly in recent years, primarily because of the rapid changes in the economy and society brought about by economic reform policies. These policies have created a corresponding need to strengthen and improve the existing legal structure. The recent rapid pace of legal development presents the Chinese government with the difficult task of striking a balance between the need to develop the legal system further to match changing economic realities and the need to maintain a degree of certainty and predictability for entities and individuals affected by the new developments.

4.3 The current Chinese legislative bodies

According to the Legislation Law of the PRC 2000,[70] the Chinese legislative system is characterised by three levels, namely, the central legislative body (the National People's Congress and its Standing Committee), the central government (the State Council)[71] and the regional legislative bodies (local people's congresses and standing committees). The principal law-making institution of the Chinese State is the NPC and its Standing Committee.[72] The NPC has the power to enact and amend laws, such as Criminal Law, Civil Law, Laws of State Organs and other Organic Laws.[73] The Standing Committee of the NPC has substantial law-making powers and may enact or amend all laws other than those which are reserved for the NPC.[74] As there is usually a substantial interval

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[70] It is was adopted at the 3rd Session of the 9th PNC on 15 March 2000 and became effective on July 1, 2000.

[71] The State Council, that is, the Central People's Government, of the PRC is the executive body of the highest organ of state power. it is the highest organ of state administration.

[72] See the Legislation Law 2000 (PRC), art.7, it states: "The NPC and its Standing Committee exercise the legislative power of the state."

[73] *Ibid.*

[74] *Ibid.*

between the meetings of the NPC, the NPC Standing Committee plays an important law-making role when the NPC is not sitting. The Standing Committee is also vested with the power to make supplementation and amendment for the laws which are enacted by the NPC during an interval of the meetings of the NPC, but such supplementation and amendment must not conflict with the fundamental principles of the corresponding laws.[75]

The State Council has the rule-making powers and may make administrative regulations in accordance with the Constitution and statutes.[76] These regulations shall include matters (1) in respect to the necessities of enacting administrative regulations in order to implement the provisions of a statute; and (2) within the functions and powers of the State Council's administration.[77]

The people's congresses and their standing committees of provinces, autonomous regions and municipalities may enact local regulations in accordance with the local special situations and these regulations must not conflict with the Constitution, statutes and administrative regulations.[78] Also, by virtue of the Legislation Law 2000, ministries and commissions of the State Council, the People's Bank of China, Auditorial Office and institutions with administrative functions which are under direct leadership of the State Council may, according to the State Council's administrative regulations, decisions and orders, enact regulations within their respective authorisation.[79] These regulations shall deal with the matters on the implementation of the laws of the NPC, or the State Council's administrative regulations and decisions or orders.[80]

In accordance with the hierarchy of the law-making power, Chinese law can be divided into four levels:

(1) the Constitution,[81]

(2) laws adopted by the NPC and its Standing Committee,

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[75] *Ibid.*

[76] See the Legislation Law 2000, art. 56.

[77] *Ibid.*

[78] Legislation Law , art. 63.

[79] *Ibid.* art. 71.

[80] *Ibid.*

[81] The Constitution was enacted in 1982, and was amended in 1988, 1993 and 1999.

(3) administrative regulations adopted by the State Council, and

(4) local regulations by the people's congresses of provinces, autonomous regions and cities, and rules or regulations issued by the ministries and commissions of the State Council.

As provided by the Constitution and the Legislation Law 2000, the legal superiority descends according to the level of law-making authority. The Constitution is the highest and fundamental law of the PRC,[82] which is supreme over all other laws, so any law which contravenes the Constitution is void.[83] The second level is the laws enacted by the NPC and its Standing Committee. These laws are usually supplemented by more detailed rules and regulations promulgated by the State Council or its affiliated ministries. Local people's congresses and their standing committees at various levels are permitted to enact regulations suitable to local conditions, provided that such regulations do not contravene the Constitution, the laws or regulations adopted by the NPC and its Standing Committee as well as the State Council.

4.4 The current Chinese judicial system

Under Chinese Constitution, the people's courts of the PRC are the judicial organs of the State.[84] The people's courts of the State are created by the people's congresses to which they are responsible and by which they are supervised.[85] Before the economic reform, Chinese courts essentially existed in form but not in substance, and they all but disappeared during the Cultural Revolution. The judicial system has been extensively rebuilt since 1979. Under the Organic Law of the People's Court,[86] the hierarchy of the people's courts divided into four levels:

- the Supreme People's Court,
- higher people's courts,
- intermediate people's courts, and
- the basic people's courts.

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[82] See Constitution, art. 5; and the Legislation Law, art. 78.
[83] *Ibid,* see also the Preamble of the Constitution.
[84] The Constitution, art. 123.
[85] *Ibid,* art. 3.
[86] The Organic Law of the People's Court was adopted in 1954, and was amended in 1979 and 1983.

At the top is the Supreme People's Court in Beijing; the following three levels are generally referred to as "local people's courts". The higher people's courts include centrally administered cities like Beijing and Shanghai and autonomous regions like Tibet and Xingjiang, in addition to each of China's provinces. By the end of August 1995, there were 30 higher courts in China.[87] Intermediate people's courts are courts at prefectures of a province or autonomous region, municipalities directly under the Central Government or directly under jurisdiction of a province or autonomous region or autonomous prefecture. By the end of 1994, there were 391 intermediate people's courts.[88] At the lowest level, there are the basic courts of rural counties and urban districts. It was reported that there were 3074 basic courts by the end of 1994.[89] There are also some special courts consisting of military courts, maritime courts and railway courts.

However, the Chinese courts sometimes cannot play their rule properly because of the formidable power of the local government. Although the formal table of organisation of the judicial system is a neat pyramid topped by the Supreme People's Court in Beijing, in fact, courts are funded and judges appointed by local people's governments. As a consequence, judges are exposed to heavy local pressures that threaten the efficacy of the courts and the coherence of Chinese law.

In China, courts have no power to interpret laws; neither the Constitution nor the Legislation Law 2000 authorises the courts to interpret the laws. In China, the power of law interpretation is mainly exercised by the legislature. The Constitution and the Legislation Law entrust the NPC Standing Committee with the power to interpret the Constitution and Laws.[90] Such interpretation is called "legislative interpretation" in jurisprudence. It is said the basis of legislative interpretation is that those who make the law know the meaning of the law and are in the best position to interpret it. According to this theory, in addition to the NPC and its standing Committee, other law-making bodies, including the State Council and the standing committees of local people's congresses, should also have the power to

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[87] See the Brief Introduction to the People's Courts of the PRC, pressed by the Foreign Affairs Bureau of the Supreme People's Court of the PRC, Aug. 1995.
[88] *Ibid.*
[89] *Ibid.*
[90] See art. 67 of the Constitution and art 42 of the Legislation Law.

interpret the administrative regulations and local laws and regulations.[91] The theory of legislative interpretation requires restraints of the judicial power in relation to interpreting laws and regulations. So in China, the court has no power to interpret the law but only to implement it. Without ascertaining the meaning of law, however, the power of implementation can hardly be exercised. In this regard, the more detailed an interpretation (ascertaining meaning) is given by the legislature, the easier it becomes for the court to implement. However, in practice, the NPC Standing Committee has not yet given any formal interpretation of any law; even when it was asked to do so, it refused to exercise the power.[92] Instead, it authorised the judiciary and administrative organs certain powers to interpret laws and regulations. The Resolution of the NPC Standing Committee on Strengthening the Work of Law Interpretation[93] prescribes:

(1) all articles in laws requiring further definition or supplement stipulations shall be interpreted or stipulated by law by the NPC Standing Committee;

(2) all questions arising from court trials concerning the specific application of laws and decrees shall be interpreted by the Supreme People's Court. All questions relating to the specific application of laws and decrees in the procuratorial work of the procuratorate shall be interpreted by the Supreme People's Procuratorate. In case there is a difference in principle between the interpretations of the Supreme People's Court and the Supreme People's Procuratorate, the NPC Standing Committee shall be asked to give an interpretation or decision;

(3) all questions on the specific application of laws or decrees that do not come under judicial or procuratorate work shall be interpreted by the State Council and the responsible department;

(4) all articles of law of local character requiring further definition or supplement stipulations shall be interpreted or stipulated by the respective standing committees of provinces, autonomous regions and municipalities that formulated those regulations. All questions concerning the specific application of laws and regulations of a local character shall be

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[91] In my opinion, the Supreme People's Court should have the power to interpret laws because the court rather than the legislative bodies implement the laws. Once the law is enacted, the court must implement it, but without ascertaining the meaning of the law, the court has difficulty to implement it. If the court has the power, the law can be interpreted whenever it is necessary.

[92] See Wang Guiguo & John Mo, Chinese Law, p. 20, 1999.

[93] It was adopted at the 19th Meeting of the Standing Committee of the 5th NPC on 10 June 1981.

interpreted by responsible departments under the people's governments of provinces, autonomous regions and municipalities.

Having the power vested by the Resolution of the NPC Standing Committee, the Supreme Court, since the beginning of the 1980s, has often given its opinions regarding how a given statute or provision should be enforced. Such opinions of the Supreme People's Court have been widely regarded as interpretations of the law.

5. Insurance Legislation in China

5.1 Before the enactment of the Insurance Law

The appearance and the development of insurance law obviously followed the emergence and growth of insurance activities. As was noted earlier, in China, modern insurance was introduced in the early 19th century. But before the 20th century, foreign insurance companies had monopolised China's insurance market and all the insurance clauses, policies, and premium rates were enacted by foreign insurers.[94] In the early 20th century, China's national insurance industry grew to such an extent that some Chinese laws involving insurance began to appear.[95]

Under the control of the GMD from 1927 to 1937, several insurance laws were drawn up, namely, Insurance Law,[96] Insurance Company Law[97] and Industrial Life Insurance

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[94] Shi Zheming, *Jiefangqian de Zhongguo Baoxianye (A Brief Recollections of China's Insurance Industry before 1949)*, Insurance Studies, No.1, p.60, Beijing, China, 1983.

[95] For instance, in 1904, the Qing Government drew up a law "Qianding Daqing Shanglu" (The Commercial Law of the Great Qing Dynasty), in which some stipulations concerning the establishment of insurance companies were provided. Soon after, the Qing Government imitated Japanese Commerical Law to draw up "Daqing Shanglu Caoan" (The Draft of the Commercial Law of the Great Qing Dynasty), it gave the provisions, *inter alia*, of damage insurance and life insurance separately in the 7th and 8th chapters. But this draft was not put into practice because the Qing Dynasty was overthrown in 1911. See Ding Yunzhou, Zhongguo Baoxianfa Jianming Jiaocheng (The course on Chinese Insurance Law), p.8, 1995.

[96] The Insurance Law was published in 1929, and amended in 1937. It contained 4 chapters of general principles, damage insurance, personal insurance and supplementary.

Law and the rules and regulations of the Industrial Life Insurance, etc.[98] These laws and regulations, however, were not put into effect due to the facts that the political situation was unstable (there was a civil war between the GMD and the CCP) and that foreign insurers objected to these insurance laws and the GMD government submitted to foreign pressure. Thus, in spite of the enactment of the insurance laws and regulations, none of them was put into practice.

After the foundation of the PRC, the legislation on insurance basically reflected the characteristic of creating a socialist insurance system in China. Laws or regulations were to a large extent tinged with revolutionary characteristics for the transformation of private ownership to public ownership. At first, some policies concerning the socialist transformation of the old insurance market were issued by the government.[99] In the early 1950s, when the PICC's insurance business had just started to grow, the Chinese government issued several regulations dealing with insurance. The nature of these regulations was largely regarded as administrative orders in order to cooperate with the political and economic situation.[100]

The development of insurance laws, regulations and administration orders in the PRC was suspended from the late 1950s to the end 1970s during which the domestic insurance business was discontinued. Since the rehabilitation of the domestic insurance business in 1980, China's insurance industry has significantly developed under the new

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[97] The insurance Company Law was published in 1935 and consisted of 7 chapters. These were general principles; deposit for securities; insurance enterprises; mutual insurance society; accountant; penalty rules and supplementary.

[98] The Law of Industrial Life Insurance Law was enacted by GMD Legislative Council in 1935, which was coupled with the Rules and Regulations of Industrial Life Insurance. See Ding Yunzhou, Zhongguo baoxianfa Jianming Jiaocheng (The course on Chinese Insurance Law), p.8, 1995

[99] These included the policy of taking over GMD bureaucrats' insurance companies; the polices of utilisation, restriction and reform for the Chinese private insurance companies and foreign insurance companies.

[100] The main regulations are as follows: in December 1949, an order was issued by the Central Finance Committee, in which it decided that compulsory insurance should be offered to state owned enterprises. So 85 per sent of the PICC's business was run with state owned enterprises in 1950. In February 1951, the State Administrative Council of the Central People's Government promulgated a decision insisting on compulsory insurance for the properties owned by state organs, state enterprises and cooperatives and on compulsory insurance for passengers. See Jiao Yujie, *Guanyu Baoxian Lifa de Yanjiu Baogao (The research report on the insurance legislation),* Insurance Studies, supplementary periodical, p.145, 1990. Soon after, in April 1951, regulations of "compulsory property insurance, compulsory hull insurance and compulsory accident insurance for passengers travelling by sea, railway and air" were

economic policy. The insurance legislation has been set up to meet the very fast development of China's insurance industry. Apart from the regulations specially governing insurance business, some laws indirectly dealing with insurance have come into being. These laws and regulations constitute the legal framework of the Chinese insurance business. Before the enactment of the Insurance Law, there were mainly four pieces of laws and regulations operating in China's insurance market: the Economic Contract Law 1981 (PRC); the Regulations of the PRC on Property Insurance 1983; the Interim Regulations on the Administration of Insurance Enterprises 1985[101] and the Maritime Code 1992 (PRC).

In the Economic Contract Law 1981, articles 25 and 46 dealt with the matters of insurance. This was the first time since 1949 that the insurance industry was guided by law other than administrative orders and regulations. On this basis, in 1983, the State Council issued the Regulations on Property Insurance which provided more detailed rules about property insurance contracts. To furnish a basic regulatory framework for the insurance industry, the State Council issued the Interim Regulations of the Administration of Insurance Enterprise in March 1985. The Interim Regulations was the first comprehensive set of insurance enterprise regulations in China which played an important role in insurance operations before the enactment of the Insurance Law. In November of 1992 the Maritime Code was promulgated, in which, Chapter 12 (articles 216 to 256) deals with the matters of marine insurance contract.[102]

5.2 The birth of the Insurance Law

The three sets of laws and regulations relating to insurance made in the 1980s (the Economic Contract Law, the Regulations on Property Insurance and the Interim Regulations on the Administration of Insurance Enterprises) and the Maritime Code

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promulgated by the Central Finance Committee. See Henry R. Zheng, China's Civil and Commercial Law, p.131, Butterworths, 1988.

[101] It was enacted by the State Council on the 3rd March 1985.

[102] In Chapter 12 of the Maritime Code, it contains 6 sections: section 1, basic principles; section 2, conclusion, termination and assignment of contract; section 3, obligations of the insured; section 4, liability of the insurer; section 5, loss of or damage to the subject matter insured and abandonment and section 6, payment of indemnity. The Marine Insurance Contract Law included in the Maritime Code of the PRC is still in force even after the enactment of the Insurance Law of the PRC 1995.

played an active role in the transformation of the Chinese economic system from a centrally planned economy to a market economy and in the formation of China's insurance market. Since 1990, China's economic reform has continued to be strengthened and deepened, the market economy has primarily been established. China's insurance industry has been developing steadily and the insurance market has been further opening and expanding dramatically. Thus the fragmentary pieces of the laws and regulations in respect of insurance promulgated in the early 1980s were unable to meet the considerable changes in the insurance industry and insurance market. For example, the number of insured people under personal insurance increased from 0.1 million in 1982 to 217.35 million in 1991 and the premium income for personal insurance rose from RMB 1.59 million in 1982 to RMB 8,340.14 million in 1991 and the types of personal insurance coverage increased to 50 in 1991 compared to 20 in 1982.[103] However there had been no law or regulation guiding personal insurance which was transacted only according to personal insurance policies.[104] As to the regulations on property insurance, there were still lots of gaps to be filled. There was a lack of insurance contract law to balance the parties' rights and obligations and deal with matters of insurance contract. In addition, the Interim Regulations of Insurance Enterprises were unable to cope with the real condition of the rapid developing insurance industry. The main problems were as follows: Firstly, the People's Bank of China was then nominated by the government as the Financial Supervision and Control Department for insurance business,[105] but the range of its functions was not clearly defined and it did not provide competent administration and supervision for the insurance business. This caused, to a certain extent, some disorder in the insurance market. Secondly, there was a lack of an environment for fair competition among the insurance companies. For example, the income tax rates for different companies were quite different. The state collected 55 per cent of income tax from the state owned insurance company - the PICC, 35 per cent from Pacific Insurance Company and Pingan Insurance Company (company limited by shares) and 15 per cent from the branches of foreign insurance companies.[106] Thirdly, some insurance companies tried very hard to keep their customers and attract more new customers by

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[103] The PICC's Year Report of 1991.
[104] These policies were drafted by the PICC.
[105] Interim Regulations of Insurance Business 1985, art.4.
[106] See *Guanyu "Zhonghua Renmin Gongheguo Baoxianfa (caoan)" de Shuoming (the Explanation on the Draft of the Insurance Law of the PRC)*, by Zhou Zhengqing, the vice-president of the People's Bank of China, Feb. 1995.

inappropriately reducing the premium rate and other undue means. Consequently the compensation ability of the insurance companies was weakened. Fourthly, some enterprises began to run, directly or indirectly, insurance business without approval of the Financial Supervision and Control Department. Such enterprises, in fact, had neither strong capital nor insurance managing experience, thus the interest of insurance consumers could not really be protected. Under these circumstances, it was imperative to draw up a comprehensive insurance law.

In October 1991, authorised by the State Council, the People's Bank of China (it then played the role as of Financial Supervision and Control Department) set up an insurance law drafting group to prepare the new legislation of insurance law.[107] After two years hard work, the draft of the Insurance Law of the PRC was completed and submitted to the State Council for consideration in September 1993. After several corrections, the draft was eventually passed at the 29th Meeting of the Standing Committee of the State Council and then introduced as the Bill of the Insurance Law of the PRC to the NPC for consideration. The Bill consisted of 5 chapters and 145 articles. The Legal Committee of the NPC examined the Bill carefully one article after the other. The revised Bill was adopted on 30th June 1995 by the 14th Session of the Standing Committee of the 8th NPC and was put into effect on 1st of October 1995. The Insurance Law consists of 8 parts (152 Articles), which are general provisions, insurance contracts, insurance companies, insurance business rules, supervision and administration of the insurance industry, insurance agents and insurance liability, and supplementary. The full text of the Insurance Law can be seen in Appendix One.

The Insurance Law is the first comprehensive set of insurance laws since the establishment of the PRC in 1949. It has an important significance in insurance history,

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[107] The law drafting group consisted of 10 persons (4 from PBC, 4 from PICC, 1 from the Pacific Insurance Company, and 1 from Pingan Insurance Company). The drafters collected, translated and studied insurance laws of 16 countries and regions, including Britain, America, Japan, Hong Kong, Taiwan etc. During the process of drafting, they investigated the attitudes and opinions of the PICC and its branches on the Interim Regulations of Insurance Company and other existing insurance regulations and asked them for suggestions on the drafting of the new insurance law. The drafting group also invited experts, legal scholars and leaders from universities, relevant ministries of the State Council, the Bureau of Legislative Affairs, the Bureau of Judicial Affairs and the PBC as well as the PICC to discuss the possible contents of the Insurance Law of the PRC. The group also contacted some foreign insurance law experts for their opinions and suggestions.

theory and practice. In combination with other pertinent statutory provisions, it represents a basic legal framework for insurance operations, and is playing a significant role in the development of China's insurance industry and the growth of China's insurance market. The Insurance Law has several features.

(1) Most insurance laws of the other countries and regions of the world have not contained the objectives of legislation on insurance law. The Insurance Law, however, expressly stipulated the objective of the legislation. In the first article of the Insurance Law it states: "This law is formulated in order to regulate insurance activities, protect the lawful rights and interests of the parties in insurance activities, strengthen the supervision and control of the insurance industry and promote the healthy development of the insurance business." This article makes it very clear that the Insurance Law aims to provide legal protection for the healthy development of the insurance industry and the insurance market and to promote the growth of a socialist market economy.

(2) The Insurance Law combines the insurance contract law and insurance company law into one. Thus the Insurance Law not only adjusts the relations between the two parties of the insurance contract, but also adjusts the relations between the State and insurance companies; it also governs the activities of insurance intermediaries (insurance agents and brokers).

(3) The Insurance Law reflects the legislative principle of tailoring this law to China's own circumstances. This principle means that the legislation on insurance not only is in accordance with the aims of the State regarding reforms of the insurance structures, but also gives consideration to the actual situation[108] that insurance companies were being transformed from old system to new one.

(4) The Insurance Law also reflects the efforts of the law drafters to keep the law in line with international practice. During the process of the preparing and drafting of the Insurance Law, the drafters collected, translated, consulted and referred to 16 countries' and regions' insurance laws and regulations. The Law adopted many internationally accepted principles and concepts regarding insurance contracts and

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[108] In other words, China's insurance companies are on the way to establish a modern enterprise system characterised by operating independently, assuming their own responsibility for their profits and losses and developing business of their own accord.

insurance business. This is for the purpose of the incorporation of China's insurance market into the international insurance market in the near future.

Following the general pattern of the legislative hierarchy in China, the Insurance Law has been supplemented by the Tentative Regulations on Administration of Insurance Enterprises 1996, the Regulations on Administration of Insurance Agents 1997 (on trial) and the Regulations on Administration of Insurance Brokers 1998 (on trial)[109] and also the Regulations on Administration of Insurance Companies 2000.[110] However all these regulations are concerned with the insurance companies, agents and brokers, there is still a lack of detailed rules or judicial interpretation concerning insurance contract.

Having acquired background knowledge about China's insurance industry and insurance law, we are now better prepared to embark on the task of investigating the fundamental principles of insurance contract law which will be dealt with in the next three chapters. Although the Insurance Law made a great contribution to China's insurance legal framework, it has a number of problems which will be addressed through a detailed examination of the three principles.

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[109] All these three sets of legislation were promulgated by the PBC which then acted as the FSCD for the insurance business.
[110] It was issued by the CIRC in 2000.

Chapter Three: Insurable interest

1. Introduction

Insurable interest is a basic requirement of any contract of insurance. One of the things which distinguishes contracts of insurance from general contracts is the requirement that the person taking out the policy or, for whose benefit the policy is made, has to be able to show that he has an insurable interest in the subject matter of the insurance. This requirement is imposed by insurance law in every country. In England, the most famous Act relating to insurable interest is the Life Assurance Act 1774 (hereinafter LAA 1774).[1] Other Acts relating to insurable interest are the Marine Insurance Act (hereinafter MIA) 1906 (UK)[2] and the Gaming Act 1845 (UK)[3]. In China, matters relating to insurable interest are governed by the Insurance Law 1995. In Australia the requirement of insurable interest is imposed by the Marine Insurance Act 1909 (Australia) for marine insurance and the Insurance Contracts Act (hereinafter ICA) 1984 (Australia) for general insurance and life insurance. There are material differences between the Chinese, English and Australian approaches to the requirement of insurable interest. For instance, the categories of insurable interest in lives, the test of insurable interest and the time when insurable interest must attach are different in the different nations. These topics are not free from arguments by courts or commentators even in their own countries. Some different approaches on the requirement of insurable interest between the different countries are based on the other laws of the countries which directly influence the matters of insurable interest. For example, in China, parents and children are deemed to have insurable interest in each other's lives without providing further evidence of other interests,[4] while in England, the common law does not give *de jure* recognition of the parents and children having insurable interest in each other.[5] This is because in China, the Marriage Law 1980 stipulates that parents have a duty to bring up and educate their children; and children

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[1] 14 Geo 3 c 48.
[2] 6 Edw 7 c 41.
[3] 8 & 9 Vict c 109.
[4] See art. 52 (2) of the Insurance Law.
[5] See *Shilling v. Accidental Death Insurance Co.* (1857) 2 H. & N. 42; and *Harse v. Pearl Life Assurance Co. Ltd.* [1904] 1 K.B. 558.

have a duty to support and assist their parents.[6] In England, however, there is no such obligation under common law.[7] The differences of social or cultural characteristics between different countries cause different requirements for insurable interest of the life insurance contract. It is submitted that this sort of difference may have its justification to exist. However, as insurance activity is an international practice, certain matters, such as the time of the requirement of insurable interest and the test of insurable interest, should be considered to have the same rationale without being affected by the above elements. So it is the general aim in this chapter to explore the possible implications of those differences between different countries and to attempt to make suggestions as to the Chinese legal position relating to insurable interest.

As far as insurance contracts are concerned, the Insurance Law includes three parts, they are (1) General Provisions; (2) Property Insurance Contracts; (3) Personal Insurance Contracts. The requirement for insurable interest is found in two articles. Article 11 provides for the general requirement and article 52 specifically provides for the requirement in life policies. The requirement of insurable interest in property insurance is not specifically stipulated under part two "Property Insurance Contracts" in this Law, but it is governed by article 11. The absence of particular provisions for insurable interest in property insurance easily causes arguments in practice and in the judicial area. It is one of the purposes in this chapter to attempt to make suggestions to add up the provisions about insurable interest in property insurance by referring to English law and Australian law or other countries' laws if necessary.

Besides article 52, there are other provisions relating to insurable interest in life insurance, such as articles 54, 55 and 60-63. Some of them are ambiguous and contradictory. For example, article 55 contradicts article 52. In addition, in practice, perhaps the most disputed issue in relation to insurable interest in life insurance is the question that who is the beneficiary upon the death of the life insured. This question is usually caused by the situation of there being no beneficiary designated in the policy and the insurance moneys are disposed as part of the insured's estate according to article 63 of the Insurance Law. Again, in art.52, the second paragraph provides: "In

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[6] See art. 15 of the Marriage Law of the PRC 1980 and art. 21 of the amended Marriage Law 2001. The Marriage Law (PRC) was adopted at the 3rd Session of the 5th NPC in 1980 and effective as of Jan. 1981 and amended in 2001.

addition to the persons mentioned in the preceding paragraph, the proposer shall be deemed to have an insurable interest in any insured person who agrees that the proposer may conclude a contract on his life." This paragraph does not clearly express whether any person who obtains the permission of the life insured will be regarded as having insurable interest on the insured's life or whether it only applies to those persons who have some particular relationship, for instance legal or pecuniary relationship, with the life insured. This ambiguity causes many different constructions of this paragraph. Suggestions will be made for modifying these articles.

Another problem, which is a common problem in a number of countries, is the test of insurable interest. In China and England, the strict proprietary test has been adopted while in Australia the economic or pecuniary test has been adopted. What test is more reasonable is another point to be discussed.

It is therefore proposed, in this chapter, firstly to analyse Chinese statutory provisions in respect of the requirement of insurable interest to find out what problems are there in Chinese law; secondly, to examine English and Australian laws to see whether their solutions could be introduced to solve the problems with Chinese law, where necessary, approaches from elsewhere will be sought; and finally to make some suggestions and recommendations for the amendment of the Chinese Insurance Law. Specific questions will be raised in relevant subsections.

Before going on to discuss matters of insurable interest, in order to clarify some confusion caused by the different usage of terminology between Chinese law and English law or Australian Law, it is necessary to consider the parties of the insurance contract and some relative persons first. Terms "insurer", "proposer", "insured" and "beneficiary" defined in the Insurance Law do not refer to the same persons termed in English insurance law or Australian insurance law, so it is necessary to clarify this problem first.[8]

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[7] See Birds, Modern Insurance Law, (4th ed.), p. 42, 1997.

[8] This problem was analysed exhaustively by Professor Lin Xunfa in his works of Baoxian Hetong Xiaoli Lun (The Validity of Insurance Contract), pp.8-26, 1996, Taiwan. In this book he clarifies the confusion of the terms of parties of insurance contract described in the Insurance Law of Taiwan. The same problem appears in the Insurance Law 1995 (PRC).

Insurer: According to article 9 of the Insurance Law, the term "insurer" shall refer to an insurance company that concludes an insurance contract with a proposer and assumes liability for payment of insurance moneys. In China, there are two types of insurance companies, they are (1) a company limited by shares; or (2) a wholly state-owned company.[9] Any other kinds of insurance companies or individual insurers are not allowed to be established in China.[10] This term seems not to cause confusion; in England, an insurer also refers to the party who concludes an insurance contract with an insured (including insurance companies and Lloyd's insurance underwriters).

Proposer: According to article 9 of he Insurance Law, the term "proposer" shall refer to a person who concludes an insurance contract with an insurer and bears an obligation to pay a premium in accordance with an insurance contract. In England, such a person is called insured[11] or assured[12].

Insured: Article 21 of the Insurance Law declares that "the term 'insured' refers to a person whose property or physical body is covered under an insurance contract and who has the right to claim insurance moneys. Proposer may be the insured." In English law and Australian law, the term "insured" refers to the party who concludes an insurance contract with the insurer, it is equivalent to the term "proposer" referred to in Chinese law.

Beneficiary: Article 21 of the Insurance Law provides: "The term 'beneficiary' shall refer to a person with the right to claim insurance monies, as designated in a personal insurance contract by the insured or the proposer. Proposer and the insured may be beneficiaries." In England, there is no the term "beneficiary" in insurance law as such. This term is used, however, for those who benefit from trusts, where the assets are legally owned by trustees, some or even all of whom may also be beneficiaries. An insurance policy, or its proceeds, could be an asset of a trust.

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[9] See art. 69 of the Insurance Law.
[10] In fact, at present, Lloyd's underwriters of Britain are the only individual insurers in the world.
[11] See John Birds, Modern Insurance Law, (4th ed.), p.10, 1997.
[12] See MacGillivray on Insurance Law, (9th ed.), p.1, 1997. The insured or assured is also called policyholder in the Policyholders Protection Act 1975.

When Chinese law is discussed, the term referring to a certain party described in the Chinese Insurance Law will be used, and otherwise the term referring to a party will conform to those defined in English law.

2. The Nature of Insurable Interest in Insurance Law

The nature and function of insurance is to give people who are covered by an insurance economic indemnity or insurance money when he suffers a loss caused by the insured event. If he has no particular relationship with the subject-matter of insurance, he will not suffer any such loss, and he therefore cannot recover anything from the insurer. If he takes out insurance on the subject-matter of the insurance to which he has no interest at all, he is gaming or wagering which is an act against public policy and which is prohibited by law. However, gambling or wagering were legally enforceable in England in earlier times, and therefore insurance without insurable interest was allowed then. It is appropriate to give a brief examination of the origin of the requirement of insurable interest.

2.1 The origin of the requirement and the statutes relating to insurable interest in England

Requirement of insurable interest originated from England. In earlier times in England, gambling or wagering contracts were not prohibited by common law.[13] A national addiction to gambling made it inevitable that entrepreneurial gamblers should be attracted to the insurance market. With the rapid growth of the insurance industry, insurance was soon used as a new form of wagering. Marine policies without interest were enforceable, the common law courts tolerated insurance on ships[14] and marine adventure by people whose sole interest was to make a quick gain on the occurrence of the insured peril.[15] The abuse and perversion of insurance contracts led to early

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[13] *March v. Piggot* (1771) 5 Burr 2862; 98 E.R. 471; See also *Good v. Elliot* (1790) 3 T.R. 693; 100 E.R. 808.

[14] *Depaba v. Ludlow* (1720) 1 Com. 360; 92 E.R. 1112.

[15] There are other examples of gambling on insurance. It was recorded that wagers on the lives of famous people were particularly popular at this time: "A practice ... prevailed of insuring the lives of well-known personages, as soon as a paragraph appeared in the newspapers announcing them to be dangerously ill. The insurance rose in proportion as intelligence could be procured from the servants,

legislative attempts to put a stop to the distasteful practice. The first legislation was the Marine Insurance Act 1745.[16] This Act provided that, "no assurance or assurances shall be made by any person or persons, bodies corporate or politic on any ship or ships belonging to his Majesty or any of his subjects or on any goods, merchandise, or effects, laden or to be laden on board of any ship or ships, interest or no interest, or without further proof of interest than the policy, or by way of gaming or wagering, or without benefit of salvage to the assurer: and that every such assurance shall be null or void to all intents and purposes." This Act prohibited the issue of marine policies which dispensed with proof of interest or policies by way of gaming or wagering.[17] This Act was repealed in toto by the MIA 1906[18] in so far as that Act related to marine risks. Provisions relating to insurable interest established in the MIA 1906 are found in sections 4-15. Section 4(1) declares every contract of marine insurance by way of gaming or wagering void. Section 4(2) provides that a contract made without interest or without an expectation of acquiring an interest is void.[19] Subject to the provisions of this Act, every person has an insurable interest who is interested in a marine adventure.[20] In particular a person is interested in a marine adventure where he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss, or damage thereto, or by the detention thereof, or may incur liability in respect thereof.[21]

The final contribution made by the English legislature to the development of the concept of insurable interest for marine insurance came in the form of the Marine Insurance (Gambling Policies) Act 1909.[22] The 1909 Act provides criminal sanctions

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or from any of the faculty attending, that the patient was in great danger. This inhuman sport affected the minds of men depressed by long sickness; for when such persons, casting an eye over a newspaper for amusement, saw that their lives had been insured in the Alley ... they despaired of all hope, and thus their dissolution was hastened." [Cited in Clayton, *British Insurance* (1971)], p.58; See also Merkin, "*Gambling By Insurance – A Study of the Life Assurance Act 1774*" (1980) 9 Anglo-American L.R. 331.

[16] 19 Geo. 2. C. 37; Short Titles Act 1896 (59 & 60 Vict. C. 14).

[17] S.1 of the Marine Insurance Act 1745 (U.K.)

[18] 6 Edw 7 c 41.

[19] Expectation: The assured must in all cases at the time of the loss have an insurable interest legal or equitable and not merely an expectation, however probable. See Halsbury's Statutes of England and Wales, 4th ed., vol. 22. 1995 Reissue. London Butterworths, p. 21, in footnote; see also *Moran, Galloway & Co. v. Uzielli* [1905] 2 K.B. 555.

[20] S. 5(1).

[21] S. 5(2).

[22] 9 Edw 7 c 12.

against persons effecting marine insurance policies without *bona fide* interest or a *bona fide* expectation of acquiring an interest in the subject matter. Persons effecting such a policy as well as any broker or person through whom, and any insurer with whom, the policy is effected are all guilty of criminal offences.[23] It is not clear how often, if at all, any body is prosecuted under this Act, even so, the risk of prosecution may be a useful deterrent.

So far as life assurance and other forms except for marine insurance are concerned, the requirement of insurable interest was provided by the LAA 1774 which is still in force today. As it was noted, in the seventeenth and early eighteenth centuries, life assurance became better known as a practice grew up of speculating in lives,[24] a contract of life assurance was enforceable then despite the absence of any relationship between the insured and the life insured. An increase in these practices, which were clearly distasteful and which indeed could serve as an inducement to murder, led to growing concern and, ultimately, legislative action in the form of the LAA 1774. This Act has numerous limitations, while its expressed purpose was to check 'a mischievous kind of gaming'.[25] In section 1 of the LAA 1774, it stipulates "..... no insurance shall be made by any person or persons, bodies politick or corporate, on the life or lives of any person or persons, or on any other event or events whatsoever, wherein the person or persons for whose use, benefit, or on whose account such policy, or policies shall be made, shall have no interest, or by way of gaming or wagering; and that every assurance made contrary to the true intent and meaning thereof shall be null and void to all intends and purposes whatsoever." The LAA 1774 merely states in general terms that insurance without interest or by way of gaming or wagering is void.[26] It also provides that it shall not be lawful for policies to be made without inserting the name or names of the person or persons interested in the policy[27] and that no greater sum shall be recovered from the insurer by the insured than the amount of the value of his interest in the subject matter of the insurance.[28] This Act clearly does not apply to insurance of ships, goods or merchandises, for these are expressly exempted by section 4.

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[23] S. 1(2).
[24] See note 15 *supra*.
[25] See the preamble to the LAA 1774.
[26] *Ibid.* S.1.
[27] *Ibid.* S.2.

The LAA 1774, despite its title, was arguably intended to apply to all forms of insurance other than those expressly excluded in section 4, because in sections 1 and 2, it clearly mentioned "other event or events". This wording seems to suggest the Act applies to property insurance, etc., but some recent authorities have the contrary view on the application of the LAA 1774.[29]

There are no specific statutory provisions requiring insurable interest in non-marine insurance on goods and merchandises. However this does not mean that insurable interest is irrelevant to such policies for contracts of insurance without interest are wagers and are void under the Gaming Act 1845. The Gaming Act made all contracts by way of gaming or wagering null and void irrespective of their nature or content. It obviously applies to insurance contracts, no matter whether they are marine or non-marine insurance or life or non-life insurance.

The law on insurable interest in England today consists of the statutory provisions as mentioned earlier coupled with the case law that has since evolved. Where statutory provisions merely provide the bare skeleton of the law, case law forms an extremely important source of this aspect of the law. The brevity and generality of the provisions of the LAA 1774 have resulted in the development of a considerable body of case law in this area. For instance, although the Act does not state when interest must exist, it is now the law that in life insurance, insurable interest must be shown to exist only at the inception of the contract.[30] This interest must be of a pecuniary nature[31] and insurable interest is presumed to exist and proof thereof is dispensed with when a person takes out a policy on his own life[32] or on the life of his spouse.[33] The LAA

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[28] *Ibid.* S.3.

[29] In *Mark Rowlands Ltd. v. Berni Inns Ltd.* [1986] 1 Q.B. 211, at 227, Kerr L.J. stated that "this ancient statute was not intended to apply, and does not apply to indemnity insurances, but only to insurances which provide for the payment of a specified sum upon the happening of an insured event. In *Siu Yin Kwan v.Great Eastern Assurance* [1994] 2 A.C. 199, it was held that the Life Assurance Act 1774 was concerned purely with life and other non-indemnity policies, it did not apply to any species of indemnity insurance.

[30] *Dalby v. India and London Life Assurance Co.*, (1854) 15 C.B. 365; 139 E.R. 465.

[31] *Halford v. Kymer* (1830) 10 B.& C. 724; 109 E.R. 619.

[32] *Wainwright v. Bland* (1835) 1 Moo. & R. 481; 150 E.R. 334.

[33] *Griffiths v. Fleming* [1909] 1 K.B. 805.

1774 was, at one time, held by common law to apply to insurance on real property.[34] It is now held to have no application to indemnity insurance.[35]

2.2 The nature of insurable interest

The LAA 1774 does not give an exact definition of insurable interest. The meaning of insurable interest was formulated in the classical leading case of *Lucena v. Craufurd*[36], which has been commonly quoted when discussing the nature of insurable interest. In that case, the Commissioners of Admiralty were empowered to take charge of ships captured from the Dutch. They had not taken possession of four enemy Dutch ships which had been captured but nonetheless insured them for their homebound voyage from St Helena to England. The ships were lost due to perils of the sea and the Commissioners made a claim for this loss under the policy. The House of Lords was required to decide if the Commissioners had sufficient insurable interest to support such a policy. It should be noted that although the Commissioners had not taken possession of the ships in question there was no doubt that, as a matter of course, these enemy ships would be condemned by the High Court of Admiralty as prizes of war and thereupon the Commissioners would be given possession of these ships for sale and management, as was their right under statute. Two main different views in this case which reflect the nature of insurable interest need to be examined here: the first was put forward by Lawrence J: [37]

"A man is interested in a thing to whom advantage may arise or prejudice happen from the circumstances which may attend it; and whom it importeth that its condition as to safety or other quality should continue. Interest does not necessarily imply a right to the whole or a part of the thing, nor necessarily and exclusively that which may the subject of privation, but the having some relation to, or concern in, the subject of the insurance; which relation or concern, by the happening of the perils insured against, may be so affected as to produce a damage, detriment or prejudice to the person insuring. And where a man is so circumstanced with respect to advantage or benefit but for those risks or dangers, he may be said to be interested in the safety of the thing.

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[34] *Re King* [1963] Ch. 459. See also MacGillivray on Insurance Law, (9th ed.), para. 1-154, 1997.
[35] *Mark Rowlands Ltd v. Berni Inns Ltd.* [1986] Q.B. 211; *Siu Yin Kwan v. Eastern Insurance Co. Ltd.* [1994] 2 A.C. 199.
[36] (1806) 2 B. & P.N.R. 269.
[37] *Ibid.* at 302-303.

To be interested in the preservation of a thing is to be so circumstanced with respect to it as to have the benefit from its existence, prejudice from its destruction. The property of a thing and the interest derivable from it may be very different. Of the first the price is generally the measure; but by interest in a thing, every benefit and advantage arising out of or depending on such a thing may be considered as being comprehended."

On the other hand, Lord Eldon took a more conservative view of what constitutes insurable interest and chose to limit it to an interest recognised in law, he stated:[38] "I have in vain endeavoured however to find a fit definition of that which is between a certainty and an expectation; nor am I able to point out what is an interest unless it be a right in the property, or a right derivable out of some contract about the property, which in either case may be lost upon some contingency affecting the possession or enjoyment of the party.... As to expectation of profits and some other species of interest which has been insured in later times, there is nothing to show that they were considered as insurable."

Lawrence J. formulated a wide idea that a mere expectancy or moral certainty of loss would suffice to found an insurable interest in the subject matter of insurance, while Lord Eldon's definition rests upon the insured's ownership of, or right to possess, the insured subject matter. It should be noted that Lord Eldon's narrow view has been accepted in England as a law.

Based on the classical decision of *Lucena,* the narrower approach of Lord Eldon has been adopted in Marine insurance. Thus MIA 1906, section 5(2) defines insurable interest in terms of:

(1) Subject to the provisions of this Act, every person has an insurable interest who is interested in a marine adventure;

(2) In particular a person is interested in a marine adventure where he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss, or damage thereto, or by the detention thereof, or may incur liability in respect thereof.

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[38] *Ibid*, at 321.

It is obvious, from both the decision of *Lucena* and the definition of insurable interest formulated in MIA 1906, that the limitation is thus imposed by the words 'legal or equitable relation'. The decision of the marine insurance cases and the definition for insurable interest in marine insurance apply also to non-marine insurance.[39] The typical non-marine insurance case which represents the narrow view of insurable interest is *Macaura v. Northern Assurance Co. Ltd.*[40] which will be considered later.[41] *Macaura's* decision received wide criticism, so, in some recent cases, judges resisted adopting the strict narrow view of insurable interest.[42] It will be noted shortly that the Insurance Law 1995 (PRC) adopts the English narrow approach by declaring that insurable interest refers to a legally recognised interest of the proposer in the subject matter of insurance.[43] In Australia, the ICA 1984(Australia) radically altered the English law with regard to the nature of the insurable interest required in contracts of general insurance. Especially, section 17 of the 1984 Act abandons the English narrow test of insurable interest, namely the legal or equitable interest, by adopting a wider view of the economic or pecuniary test for insurable interest[44] which has been held more reasonable and been proved welcome.[45]

3. The Requirement of Insurable Interest in Life Insurance

The issue of which persons are presumed to possess an insurable interest in the life of the life insured has lasted for long time. This is an important question for which different countries have different approaches. In England, the statutory law of LAA 1774 and common law strictly request an insurable interest when a person effects a life

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[39] See MacGillivray on Insurance Law, (9th ed.), para.1-144, 1997; See also R. Merkin, Insurance Contract Law (Loose-leaf), p. A.4.1-20.
[40] [1925] A.C. 619.
[41] See *infra* s. 5.4 of this Chapter under the title "Legally recognised interest or economic interest – the test of insurable interest in property insurance".
[42] *Sharp v. Sphere Drake Insurance, The Moonacre* [1992] 2 Lloyd's Rep 501; *National Oilwell (UK) v. Davy Offshore* [1993] 2 Lloyd's Rep 582; *Glengate-KG Properties Ltd v. Norwich Union Fire Insurance Society* [1996] 2 All E.R. 487.
[43] Art. 11, para. 3 of the Insurance Law.
[44] See s. 17 of the ICA 1984 (Australia).
[45] See A.A. Tarr, Australian Insurance Law, pp. 58-61, 1987. See also K. Sutton, Insurance Law in Australia, (2nd ed.), pp. 372-376, 1991.

policy on the life of other people. In Australia, the ICA 1984 repealed the LAA 1774[46] and confirmed and expanded the English common law categories of insurable interest in lives[47]. In New Zealand, however, there is no requirement for the insurable interest in life insurance.[48] In China, the Insurance Law gives a list specifying which persons are presumed to have insurable interest in the life of others.[49] In this section, different approaches will be examined in order to find a better one which may be considered to be introduced to the Chinese Insurance Law relating to the insurable interest in life insurance.

3.1 The provisions in the Insurance Law (PRC)

In China, the Insurance Law is the first legal statute dealing with life insurance. Article 52 sets forth the categories of insurable interest in Lives.[50] It provides:

"A proposer shall have an insurable interest in the following persons:

(1) himself;

(2) his spouse, children and parents; and

(3) Apart from the above-mentioned, other family members and close relatives bearing foster or support or maintenance relationship with the proposer.

In addition to the persons mentioned in the preceding paragraph, the proposer shall be deemed to have an insurable interest in any insured person who agrees that the proposer may conclude a contract on his life."

It is not difficult to notice that the list in the first paragraph contains family relationships only. The second paragraph talks about insurable interest in the lives of others which will be discussed separately. Each family relationship is considered as follows.

(1) Insurable interest in one's own life

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[46] See the ICA 1984 (Australia), s.3(1).

[47] *Ibid.* s.19.

[48] Insurance Law Reform Act 1985 (N. Z.), a.6.

[49] Art. 52.

[50] According to art. 91 of the Insurance Law, personal insurance businesses include life insurance, health insurance, and accident insurance. It is provided in art. 51 that the term "personal insurance

The proposer has an insurable interest in his own life. It seems that there is no opposite view on this point in any country. The modern forms of life policies are numerous, there are three main forms, namely (1) traditional whole life policy, which simply pays an agreed sum of money on the death of the life insured. This form of policy is usually effected for other persons' benefit who is maintained or supported by the life insured. Where a person dies the other persons who are living on his support will suffer a financial loss. In order to ensure that such persons have economic security after his death, the life insured can effect a policy on his own life for such others' benefit; (2) endowment insurance in which the policy matures with a specific period after issuance and becomes a claim payable to the insured at that time, or to his beneficiary upon the death of the insured before that time; (3) accident insurance which, as generally understood, is a branch of insurance closely allied to life insurance, and by which persons are enable to provide against loss to themselves or their families in case they are injured or disabled for a time or permanently, or killed, by some cause operating on them from without. No matter which form it is or whether it is for his own interest or another persons' benefits, a person definitely has an insurable interest in his own life. Due to the fact that the value of one's life and body cannot be measured by money, a person has an unlimited insurable interest on his own life.[51] Whether or not the view of "unlimited interest" is correct or reasonable is another question which will be considered later.

(2) Insurable interest in the life of one's spouse

A person has an insurable interest in the life of his/her spouse. In article 52 of the Insurance Law, for the family relationship, the first person who comes into the

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contract" shall refer to an insurance contract of which the subject matter is the life or physical body of a person.

[51] In a Chinese case, *Jiqing v. the PICC Life Insurance*, a couple effected life policies in 1995 for their son's benefit on their own lives, the insured sum was as high as Rmb1,500,000 which amounts to 100 times of a Chinese ordinary worker's annual salary. The couple died in a car accident soon after they paid the premium, and the son made claim against the insurance company. It was held that the insurance contract was not effective when the insureds died because the insurer had not yet made acceptance for the proposal. For the detailed discussion on the case, see Chen Xuqin, *Juer Shouxian Suopei Yinfa de Sikao (Thingking Caused by a Claim for a Huge Sum of Money)*, Chinese Legal Science, No. 2, pp. 114-119, 1997. Although the argument on this case is not focused on the point of the huge insured amount, I cite it here in order to show that in China there is no limitation for the sum of insurance when a person effects a life policy in his own life. As to the point of unlimited interest in one's own life, see also Zhang Wenzhong, China Insurance, No. 2, p.46, 1999. In his article, more examples are found.

category of this article is one's spouse.[52] Even if before the enactment of the Insurance Law, by virtue of the Chinese Marriage Law 1980[53] and the nature of the insurable interest,[54] a person is deemed to have an insurable interest on his/her spouse. According to Marriage Law, a husband and wife have a legal obligation to maintain each other. If one party fails to perform this duty, the party in need of maintenance has the right to demand maintenance payments from the other party.[55] A husband and wife have an unlimited pecuniary interest, so a husband has an unlimited insurable interest on his wife's life and vice versa. However, when a person effects a policy upon his spouse's life for his own benefit, he has to get the permission of his spouse.[56]

(3) Insurable interest in the lives of one's children

Article 52(2) makes it clear that a parent has an insurable interest in the life of his children. This provision is in conformity with the stipulation of other Chinese laws. It is stipulated in the Marriage Law that parents have the duty to bring up and educate their children; while children have the duty to support and assist their parents.[57] It is a legal obligation for an adult child to support his elderly parents. If the child fails to perform his duty, parents who are unable to work or have difficulty in providing for themselves have the right to demand support payments from their child.[58] Such parents can also take action against their child if he/she refuses to supply the maintenance.[59] It is obvious that the death of the child amounts to the cessation of the

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[52] Art.52(2).

[53] The Marriage Law (PRC) was enacted in 1980, and was amended in 2001.

[54] As was noted above, insurable interest is defined as a legally recognized pecuniary interest in the subject matter of insurance. See art. 11 of the Insurance Law (PRC); See also MacGillivray on Insurance Law, (9th ed.), Para. 1-9, 1997.

[55] Art. 14 of the Marriage Law 1980 (PRC); see also art. 20 of the amended Marriage Law 2001. In China, insurable interest does not extend to the relationship of fiance and fiancee let alone the relationship of cohabitant. In England, fiance and fiancee, and even cohabitants are presumed to have an insurable interest on each other. See s. 3.2 of this Chapter "the English approach relating to insurable interest in life insurance", *infra.*

[56] In art.55 of the Insurance Law, it states " a contract in which the death of a person whose life is insured is set as the condition for payment of the insurance moneys shall be void where such contract has not been agreed by and the sum insured has not been approved by the insured in writing".

[57] See art. 15, Marriage Law 1980; see also art. 20 of the amended Marriage Law 2001.

[58] *Ibid.*

[59] In art.15 of the Civil Procedure Law 1991 (PRC), it is stated: "Organs, social organizations, enterprises and institutions may support the injured units or individuals to file a suit with the People's Court against acts that damaged the civil rights or interests of the state, collectives or individuals." In practice, actions are often taken by elderly parents whose sons or daughters do not supply maintenance to them.

financial support. It is therefore presumed that parents have an insurable interest in their child.[60]

A parent may effect a policy for his own benefit on the life of his adult children. This is easy to understand because he is dependent on them and he would clearly suffer financially by the loss of a legal right on their death. However it is worth noting that an interesting provision enabling a parent to have an insurable interest on his minor children is found in the Insurance Law.[61] The law does not allow a person to effect a death policy with an insurer on the life of a person who has no capacity for civil acts, this is expressly prohibited in article 54. However a life policy effected by a parent on the lives of his minor children is regarded as an exception from this prohibition.[62] The only restrictive condition for a parent taking out a life insurance on the lives of his minor children is the insured amount which should not exceed the limit set by the FSCD.[63] The origin and rationale of this provision in the law which allows a parent to take out insurance on his minor children is unclear.[64] According to the nature of insurable interest, in all the relationships where insurable interest is presumed to exist, there runs a common connecting thread, *i.e.* there is some form of pecuniary or

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[60] Based on the Marriage Law, the insurable interest may extend to the relationship of the unmarried mother or father and their children. Because in art. 19 of the Marriage Law, it is stated: "Children born from unmarried couples have the same legal position as those born from married couples." The step-parents and the step-children may also be presumed to have insurable interest in each other, so do the foster-parents and foster children, because the Marriage Law gives them the same rights and imposes on them the same obligations as those of the natural parents and their children. See arts. 20 and 21 of the Marriage Law; arts. 25-27 of the amended Marriage Law 2001. See also Yu Xinnian, Zuixin Baoxianfa Tiaowen Shiyi (The Most Recent Interpretation on the Articles of the Insurance Law), p. 129, 1995. In his book, he agrees that the insurable interest in one's child may extend to the child who is a child born out of wedlock, or a step-child or a foster-child. See also Hu Wenfu, Shangye Baoxianfa Tonglun (An Introduction to Commercial Insurance Law), p. 155, 1996, he has the same view.

[61] Art.55.

[62] See the second paragraph of art.54.

[63] *Ibid.* However, the limitation of the sum insured was not drawn by the FSCD until March 1999. The sum insured on the life of a minor child is now limited not beyond RMB 50,000, which was stipulated by the CIRC through the notice of "the limitation of the sum insured for a death insurance taken out by a parent on his minor child". See the Document of CIRC, No.43, 22 March 1999. Prior to the Document, in practice, the insured sum on such a policy was usually 15 or 20 times of the parent's annual salary, that meant the sum insured was around RMB 200,000. This was discussed through a letter with Mr Wu Yue, who was the former general manager of the PICC, Shanghai branch.

[64] There are other countries where the insurance laws permit a parent or a guardian to effect a life policy on the life of his minor child or ward. Australian law affirms the existence of the insurable interest for parents to take out life insurance on their children's lives. In s.19 (2) of the Australian ICA 1984, it states "A parent of a person who has not attained the age of 18 years, and a guardian of such a person, has an insurable interest in the life of that person." Malaysia and Singapore also adopt this approach. See s.40 (2) of the Insurance Act 1963 (Malaysia); See also s.59 of the Insurance Act (Singapore), Cap 142, Rev Ed 1994. However, in England, under common law, the case of *Halford v. Kymer* (1830) 10 B. & C. 724; 106 E.R. 619, made it clear that, in the absence of evidence of pecuniary interest, a parent does not have an insurable interest in the life of his minor child.

financial dependence, by the person insuring upon the life insured. The same form of dependence cannot be said to be present in the parent and minor child relationship. The dependence in such a relationship is that of the child upon his parent, rather than the reverse. Parents are certainly not pecuniarily dependent upon their minor children.[65] The death of a person's minor child would not cause much financial loss for the parent except the funeral expenses. However, it is submitted that the following reasons may support the view that a parent has an insurable interest on his minor child. First, it might be the legislator's thought that it is less likely for a parent to murder his own child for insurance money.[66] Secondly, there is a limit of the sum insured for such a policy[67] which may avoid or reduce the temptation of moral hazard. Thirdly, as has been suggested by a commentator[68] that in law, such expenses (spending by a parent on his child) would constitute the supply of necessaries which is a recoverable expense. Such expenses would be at risk if the child dies. On these grounds, it is suggested that article 54 second paragraph does not depart from public policy. Furthermore, as a Chinese writer comments: "in order to protect the life of the minor child and by virtue of the second paragraph of article 60 of the Insurance Law, when a father effects a policy on his minor child's life for the father's own benefit, the mother of the child should acts as his legal guardian to designate the father as a beneficiary."[69] In other words if the father, in this case, designates himself as the beneficiary, he must get the permission of the child's mother. This view is reasonable and which should be adopted in practice in order to give the minor child an adequate protection.

It is certain that a parent has a right to insure on his minor children for an accident or sickness insurance. Because parents have a legal obligation to their minor children for

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[65] But they could later become so as discussed below.

[66] Indeed, such moral risk rarely happens between parents and their children, but it cannot be said that it has never happened. In China, upon some investigation, it has been found that in insurance claims under the life policies on minor children, the rate of death of baby girls has been higher than that of boys, especially in the countryside. See Wei Shengqing, *Guanyu Renshen Baoxian Kebaoliyi Wenti de Tantao (Discussion on the Insurable Interest in the Life Insurance),* Shanghai Insurance, No. 8, p.16, 1995. In China, population control has been practiced under which one couple is allowed to have only one child, but in rural areas, the couples who have a baby girl are permitted to have a second child. Because of the influence of Chinese tradition, most couples like baby boys. If a couple has two girls, it is not unlikely to induce a murder to one of the girls for the purposes of recovering the insurance moneys and of having another baby.

[67] Art.54 (2) of the Insurance Law.

[68] See Poh Chu Chai. Law of Insurance, vol : Principles of Insurance Law (4th ed.), p.26, 1996. This author discusses about s. 59 (2) of the Insurance Act of Singapore 1994. It is submitted that his suggestion could be borrowed to explore the rationale of the approach that a parent has an insurable interest on his minor child.

their living and education etc,[70] if such children are injured by accident or get sick, the parents must suffer financial loss, so there is no doubt that a parent has an insurable interest in the lives of his children for such kinds of policies.

(4) Insurable interest in the lives of one's parents

That a child has an insurable interest in his parents is affirmed by the Insurance Law.[71] The basis of this view is perhaps the Marriage Law in which a parent is legally obliged to support his child. If the parent fails to do so, the child who needs his parent's support has the right to demand the costs of upbringing from his parent.[72] So, it is clear and reasonable that a child who is minor has an insurable interest in the life of his/her parent, [73] as the former would undoubtedly suffer financially if his/her parent die.

In China, a person who has completed his 18th year is an adult,[74] so a child under 18 is deemed to have an insurable interest in his/her parents. However in China, as the lawful age of marriage is 22 for a man and 20 for a woman,[75] it might be inferred that a man who is under 22 and a woman who is under 20 has an insurable interest in his or her parents because such children still live with their parents before they get married. In fact some of them at this age are still in college or university, so they still need their parents' support to finish their education. They are therefore presumed to have an insurable interest in their parents.

A question arising from this area is whether or not a person who is married or not married but over the lawful age of marriage has an insurable interest in his parents' lives. This case seems not to be precluded from the categories of insurable interest in

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[69] Zhou Yongsheng, Baoxian Yu Falu (Insurance and Law), p. 137, 1998.
[70] Art.15 of the Marriage Law 1980, and see also art. 21 of the amended Marriage Law 2001.
[71] Art.52(2) of the Insurance Law.
[72] Art. 15 of the Marriage Law 1980; see also art. 21 of the amended Marriage Law 2001.
[73] According to art. 12 of the Civil Law, a child between 10 and 18 years old is a person with limited competence, who can enter into a contract of insurance with the written consent of his or her parent or guardian. A minor under 10 years of age is a person without capacity for civil conduct, his conduct of the effecting of an insurance contract must be represented by his parents or guardian.
[74] See the General Principles of Civil Law of the PRC 1986 (hereinafter the Civil Law) which was adopted at the 4th Session of the 6th National People's Congress on April 1986, and effective as of I Jan. 1987. Art. 11 provides "A citizen aged 18 or over shall be an adult; he has full competence to perform civil acts and may engage independently in civil activities; he is a person with full competence to perform civil acts."
[75] Art. 5 of the Marriage Law 1980; see also art. 6 of the amended Marriage Law 2001.

the lives described in article 52 (2) of the Insurance Law. If the nature of insurable interest in life insurance is founded only on an economic or pecuniary relationship, this question should be given a negative answer as an adult child is not dependent financially any more (if he has finished his education or not disabled) on his parents and the parents have no legal obligation to support him. If an insurable interest is based on affection or mutual assistance between an adult child and his parents, this case should be allowed to exist. However, many laws or authorities indicate that the former view should be correct[76] and no supporter has been found for the latter. One Chinese scholar has the same point of view that "when a child grows up and is financially independent or gets married, the insurable interest on the life of his parent shall disappear and the life policy he has already effected on the life of his parent (if any) should terminate."[77] Article 52 (2) of the Insurance Law is ambiguous on this point. It is submitted that such a case cannot constitute an insurable interest in life insurance.

(5) Insurable interest in the lives of other family members of the insured and close relatives by whom one is maintained and supported

Finally, insurable interest is deemed to exist under article 52 of the Insurance Law when a person takes out a policy on the lives of other members or close relatives by whom he is raised or supported. Combining the Insurance Law with the Marriage Law, the following relationships should fall into this category:

a. Grandparents and grandchildren;
b. Elder brothers (or elder sisters) and younger brothers (or younger sisters)

Whether or not an insurable interest exists between a grandparent and a grandchild is not an easy question and depends on whether or not they are dependent on each other. Unlike the relationship of parents and children who have a legal obligation to maintain or support each other, between grandparents and grandchildren, this obligation is imposed only under some special situations. Thus not all of them have an insurable interest on each other's life. The Marriage Law stipulates that "Grandparents who can

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[76] See s.3 of the LAA 1774 (UK); J. Birds, Modern Insurance Law, (4th ed.) p. 41, 1997; See also MacGillivray on Insurance Law, (9th ed.), para. 1-9, 1997.
[77] Zhou Yongseng, Baoxian yu Falu (Insurance and Law), pp. 134 –135, 1998.

afford it shall have the duty to bring up their grandchildren who are minors and whose parents are dead. Grandchildren who can afford it shall have the duty to support their grandparents whose children are dead."[78] In accordance with this provision, grandparents are legally obliged to bring up their grandchildren who are minors and whose parents have died. The grandchildren therefore, in such a situation, have an insurable interest in the lives of their grandparents. It applies vice versa. In this case where one person effects a policy on the other he must show the evidence that he is lawfully supported or maintained by the other in a pecuniary sense.

The position of the relationship between elder brothers/sisters and younger brothers/sisters is much the same as between the relationship of grandparents and grandchildren.[79] This interest may extend to other relationships, such as, uncle/aunt and nephew/niece father/mother in law and son/daughter in law, where they are financially dependent, for article 52 of the Insurance Law contains the relatives of the insured.

3.2 The English approach relating to insurable interest in life insurance

In England, life insurance is governed by the LAA 1774. Under s.1 of this Act no insurance is to be made on lives by persons having no interest. It reads: "From and after the passing of this Act no insurance shall be made by any person or persons, bodies politick or corporate, on the life or lives of any person or persons, or on any other event or events whatsoever, wherein the person or persons for whose use, benefit, or on whose account such policy or policies shall be made, shall have no interest, or by way of gaming or wagering; and that every assurance made contrary to the true intent and meaning hereof shall be null and void to all intents and purposes whatsoever." In this section there is the general requirement of insurable interest in the life or lives insured in order to prevent mischievous kinds of gaming. This section operates alongside the common law. There are two cases being presumed outside the mischief of wagering which the 1774 Act was passed to prevent, insurance on the

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[78] Art. 22 of the Marriage Law 1980; see also art.28 of the amended Marriage Law 2001.
[79] See art.23 of the Marriage Law 1980 or art. 29 of the amended Marriage Law 2001. It is said: "Elder brothers or elder sisters who can afford it shall have the duty to bring up their younger brothers or sisters who are minors, if their parents are dead or have no means to bring them up."

insured's own life[80] or on the life of a spouse[81]. An insured is conclusively presumed to have an unlimited insurable interest in his or her own life. The LAA 1774 itself makes no exceptions to the requirement of insurable interest in life insurance, but the common law however has long recognised that insurable interest need not be proven when a person insures his own life.[82] The requirement of insurable interest in such a situation could not have been justified either with the aim of avoiding wagers or of preventing destruction.

Under common law in England the spouse is the only family relationship where the existence of insurable interest is presumed. A husband has an unlimited insurable interest in his wife's life[83] and a wife has an unlimited insurable interest in her husband's life[84]. The fact that a husband is presumed to have an insurable interest in the life of his wife and that it was unnecessary to give affirmative evidence to that effect was first recognised in *Griffiths v Fleming*[85] where it was held that insurable interest was to be presumed irrespective of whether the husband did or did not depend upon his wife in the pecuniary sense. The same is true as regards the interest of the wife in the life of her husband. It was held in *Reed v Royal Exchange Assurance Co.*,[86] that a wife insuring the life of her husband need not prove that she had an interest therein. The common law is supplemented by the Married Women's Property Act 1882. In section 11 of this Act, it provides that a married woman has the right to effect a policy upon her own life or on the life of her husband for her own benefit; and a policy taken out by a man for the benefit of his wife or children, or by a woman for the benefit of her husband and children, creates a statutory trust of the policy in the hands of his or her executors, free of his or her debts.[87] In practice, this presumption

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[80] *Wainwright v. Bland* (1835) 1 Moo & R. 481; 150 E.R. 334.
[81] *Griffiths v Fleming* [1909] 1 K.B. 805.
[82] In *M'Farlane v The Royal London Friendly Society* (1886) 2 T.L.R at p.755, Pollock B said that there was nothing to prevent any person from insuring his own life as many times as he likes for his own benefit, even though at the time he has the intention of assigning the policies to another person.
[83] *Griffiths v. Fleming* [1909] 1 K.B. 805.
[84] *Reed v. Royal Exchange Assurance Co.*, (1795) Peake, Add. Cas.70; 170 E.R. 198.
[85] *Griffiths v. Fleming* [1909] 1 K.B. 805 at p.821.
[86] *Reed v. Royal Exchange Assurance Co.*, (1795) Peake, Add. Cas.70; 170 E.R. 198.
[87] S.11 of the Married Women's Property Act 1982 (UK).

probably extends to the fiance(e) insuring the life of his or her fiance(e),[88] and even to the relationship of cohabitation.[89]

In England, in all other family relationships than spouse there is no presumption of any insurable interest, unless some sort of financial reliance is shown. In the absence of proof of interest it has been held that:

(1) a parent cannot insure his child;[90]

(2) a child cannot insure his parent;[91]

(3) remote family relationships such as brother or sister, grandparent or grandchild do not give rise to insurable interest.[92]

Unlike in China, in England, there is no legal obligation in common law for parents to support their children,[93] so it is presumed that a child has no insurable interest on his or her parents' lives. However, statutory procedures may lead to such an obligation. For example, if a maintenance order has been made, compelling a parent to provide for a child, the child must have an insurable interest in the parent's life.[94] An adult child has no insurable interest in his parent's life,[95] unless he can prove some legal obligation arising on the death of his parent. Similarly, there is no legal obligation in common law for a child to support or maintain his parents, so the parents have no insurable interest in the life of their child. In *Halford v Kymer*[96] a father attempted to insure the life of his son, naming himself as beneficiary, should the son die within two years. The father expected that the son would reimburse him the cost of his education and maintenance at some date in the future, but the court rejected the father's claim on the

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[88] John Birds, Modern Insurance Law, (4th ed.), p. 41, 1997. This is certainly the view of one Insurance Ombudsman; see the Annual Report for 1989, paras. 2.31–2.35. It suggested that the presumption should also apply to an unmarried couple living together.

[89] Although the insurable interest on the relationship of cohabitation is not recognised by law, in practice some insurers do offer cover and the Insurance Ombudsman will enforce it. The Scottish Law Commission has recommended that this practice should be confirmed by statute and, moreover, that no qualifying period of cohabitation should be required; see Report 135 on Family Law, para. 16.41.

[90] In *Halford v. Kymer* (1830) 10 B. & C. 724, it was held that a policy effected by a father in his own name on the life of his son, he not having any pecuniary interest therein, was void. See however, s. 99 of the Friendly Society Act 1992, which allows up to £800 to be recovered under friendly society policy by a parent on a child where there is no insurable interest.

[91] *Shilling v Accident Death* (1857) 2 H & N 42; *Harse v Pearl Assurance* [1904] 1 K.B. 558.

[92] *British Workman's Assurance v. Cunliffe* (1902) 18 T.L.R. 502.

[93] *Bazeley v. Forder* (1868) L.R. 3 Q.B. 559.

[94] John Birds, Modern Insurance Law, (4th ed.), p. 42, 1997.

[95] *Shilling v. Accident Death* (1857) 2 H. & N. 42; 157 E.R. 18; *Harse v. Pearl Life assurance Co., Ltd.* [1904] 1 K.B. 558.

[96] (1830) 10 B. & C. 724; 109 E.R. 619.

ground that he had no pecuniary interest in his son's life as there was no legal obligation for him to support his son for the education and the son had no legal obligation to reimburse his father.

The amount of insurance money is restricted under section 3 of the LAA 1774, where it is stated in all cases where the insured has an interest in such life or lives, event or events, no greater sum shall be recovered from the insurer or insurers than the amount of value of the interest of the insured in such life or lives or other event or events. So in all the cases except the insured himself and the relationship of spouses a strict pecuniary interest in the life insured was required and it was essential that the person claiming to have an insurable interest should show that he would suffer financially by the loss of a legal right on the death of the life insured, and the amount recoverable was limited to the extent of the pecuniary interest. For example, in *Harse v. Perarl Life Assurance Co. Ltd*[97] it was held that a moral obligation to pay a person's funeral expenses was insufficient to support an insurable interest in the latter's life and therefore, there being no legal obligation upon a son to bury his mother, the son had no insurable interest in his mother's life.

However, as English law relating to insurable interest in life insurance has created such a narrow definition, it is deemed too harsh and restrictive to suit the reality of modern situations, in either domestic or commercial settings, and it may well be that insurers do not necessarily abide by these outdated rules. If the insurable interest is tied by affection, it is submitted that not only husband and wife or fiance and fiancee have affection, but also the children and parents who are blood tied. If the rule of insurable interest is founded on an economic or pecuniary interest, it is not correct to be said that only spouses are financially dependent (even extended to fiance and fiancee) but parents and children are not.[98] If the requirement of insurable interest is founded on the purpose of preventing the temptation of murder and to avoid the mischievous kind of gaming,[99] it is not convincing to say that a mother is more likely to kill her child than her husband, or a husband would suffer more loss financially than

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[97] [1903] 2. K.B.92; [1904] 1 K.B. 558.

[98] Although in England, there is no legal obligation at common law for parents to support their children, (*Bazeley v. Forder* (1868) L.R. 3 Q.B. 559), in practice most parents, if not all, support their children where living and education are concerned.

[99] See the preface of the LAA 1774.

her child. If the rule is founded on the basis of legally recognised interest the relationship of parent-child is satisfied. As far as the relationship of fiance and fiancee or the relationship of cohabitation are concerned, the English approach is more unconvincing. It is really doubtful that a parent is more likely to murder his child or a child has more motive to kill his parents for insurance money than that a person will kill his cohabiting 'partner' or a fiance kills his fiancee. So in recent years, this classical Act, which has lasted more than 200 years, and old cases have received a lot of criticism. Reform of the current English law has been suggested. As Professor Birds comments: "The law on insurable interest in life insurance is clearly out of touch with reality in many respects, as has been pointed out in the preceding amount. It is suggested that a general reform is necessary which might well follow the useful precedent set by the ICA 1984 (Australia)."[100] So in this connection, it is worthwhile to look at Australian insurance law.

3.3 Australian approach in respect of insurable interest in life insurance

The ICA 1984 (Australia) repealed the LAA 1774 (UK) in its application to a contract or proposed contract of insurance to which the new legislation applies.[101] However, the ICA 1984 preserves the requirement of insurable interest at the inception of the insurance as a condition of the validity of the insurance, for life insurance and sickness or accident insurances which include death cover. In section 18 of this Act, it is clearly stipulated that (1) where the insured under: (a) a contract of life insurance; or (b) a contract that provides for the payment of money on the death of a person by specified sickness or accident, did not, at the time when the contract was entered into, have an insurable interest in the life of the life insured or of each life insured, the contract is void.

The ICA 1984 expanded the categories of insurable interest in life insurance of family relationship restricted by English common law. Section 19 of this Act gives wider categories of insurable interest in lives:

(1) A person has an insurable interest in his own life and in the life of his spouse.

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[100] See J. Birds, Modern Insurance Law (4th ed.), p. 48, 1997.
[101] See the Australian ICA 1984, s. 3(1).

(2) A parent of a person who has not attained the age of 18 years, and a guardian of such a person, has an insurable interest in the life of that person.

(3) A person who is likely to suffer a pecuniary or economic loss as a result of the death of some other person has an insurable interest in the life of that other person.

(4) Without limiting the generality of sub-section (3),

(a) a body corporate has an insurable interest in the life of an officer or employee of the body corporate;

(b) an employer has an insurable interest in the life of his employee and an employee has an insurable interest in the life of his employer; and

(c) a person has an insurable interest in the life of a person on whom he depends, either wholly or partly, for maintenance and support.

It is clear that the categories of insurable interest in lives set as in section 19 are much wider than those established in common law. Under section 19, in addition to the life insured himself and the relationship of spouse, many other family relationships may also fall into these categories. Especially section 19(3) and (4)(c) establish a broad meaning of insurable interest in life insurance. By virtue of section 19(3), the likelihood of pecuniary or economic loss may constitute an insurable interest. Thus a share-trader could insure the life of the head of an industrial conglomerate on the basis that he is likely to suffer pecuniary or economic loss if the head of the concern were to die.[102] By virtue of section 19(4)(c), any person who depends, either wholly or partly, on the life insured for maintenance and support has an insurable interest in the life insured. For example, a remote relative, or even a friend, as long as he is a financial dependent of the life insured, is presumed to have an insurable interest in the life of the life insured. This is clear a departure from common law where it has been held that no such interest exists. However, under the English statutory law of Inheritance (Family Provision) Act 1938[103], amended in 1952[104] and 1975,[105] certain persons are referred to as the deceased's "dependants" and can apply for financial provision out of the deceased's estate on the grounds that the deceased's will or intestacy does not make reasonable financial provision for the applicant. According to 1975 Act, such persons are:

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[102] See, K. Sutton, Insurance Law in Australia, (2nd ed.), p.379, 1991.
[103] 1 & 2 Geo. 6 c.45.
[104] 15 & 16 Geo. 6 & 1 Eliz. 2 c.64.

(a) wife or husband of the deceased;

(b) a former wife or former husband of the deceased who has not remarried;

(c) a child of the deceased;

(d) any person (not being a child of the deceased) who, in the case of any marriage to which the deceased was at any time a party, was treated by the deceased as a child of the family in relation to that marriage;

(e) any person (not being a person included in the foregoing paragraphs of this subsection) who immediately before the death of the deceased was being maintained, either wholly or partly, by the deceased;

The above persons, in this Act, were all referred to as the "dependants" of the married person who died. By inference, such persons should also be the dependants of the person when he was alive. They therefore should be presumed to have insurable interest in the life of the person.

In summary, as far as insurable interest in life insurance in family relationship is concerned, English common law confines the categories only to the life insured himself and his/her spouse[106] which has been held too narrow to meet the modern conditions. The Australian Insurance Contracts Act expands the common law categories[107] which has been welcomed. The Chinese approach in this respect is close to the Australian approach, either in form or categories, in setting out a list of relationships in respect of which it is permissible for one person to insure the life of another.[108] The only distinction between the Chinese approach and the Australian approach is that Australian law does not admit that there is an insurable interest existing between an adult child and his parents[109] unless he can prove he is a dependant of the other[110] or will suffer loss as a result of the other's death[111], while Chinese Insurance Law does not preclude this case from the categories established in article 52. It is submitted that on this point the Australian approach is preferred.

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[105] Inheritance (Provision for Family and Dependants) Act 1975. Eliz. 2 c.63

[106] See above s. 3.2 of this Chapter "English approach relating to insurable interest in life insurance".

[107] Australian ICA 1984, s.19(3) and (4)(c).

[108] Art. 52 para.1 of the Insurance Law.

[109] Australian ICA 1984, s.19(2).

[110] *Ibid.* s.19(4)(c).

[111] *Ibid.* s.19(3).

3.4 Insurable interest in the lives of others

Insurable interest in other relationships other than family relationships are not expressly described in the Insurance Law. However, in article 52, paragraph 2 of the Law, it gives an ambiguous supplement to the first paragraph, paragraph 2 is in the following terms: "In addition to the persons mentioned in the preceding paragraph, the proposer shall be deemed to have an insurable interest in any life insured who agrees that the proposer may conclude a contract of insurance on his life." It is so broad and vague in its meaning that it is difficult to determine with certainty which relationships fall into its purview and which do not.[112]

This provision fails to stipulate whether the proposer must have (1) a legal or equitable interest; or (2) a pecuniary interest. The only requirement in this paragraph is the evidence of the life insured's consent to allow the proposer to take out insurance on his life. Questions may arise, for instance, where a person obtains the permission of his friend to effect a policy on the life of his friend for his own benefit, is it deemed that the person has an insurable interest in the life of his friend? Again, does a woman have an insurable interest in the life of her sister-in-law if the sister-in-law permits her to effect a policy on her life without an evidence of pecuniary interest between them? Pursuant to the rules of insurable interest (legally recognised and pecuniary interest) strictly, such proposers should not be deemed to have an insurable interest in the life of the life insured. Certainly, there must be some one who may say that if a person allows another to effect a policy on his life, the other person usually has a pecuniary relation with him, otherwise nobody may be so silly as to allow others to take out insurance on his life. This is only an ethical judgement, but in practice it is not unlikely that there might be such persons.

However, some Chinese scholars insist that "the proposer" mentioned in paragraph 2 of article 52 denotes the person who has a pecuniary or an economic relationship with the life insured, because the person and the insured have legal right and obligation

[112] I have discussed this question, through a letter, with Mr Wu Yue, the former general manager of the PICC, Shanghai branch. He has also recognised the ambiguity of this article and agreed with my view.

between each other, so such person is presumed to have an insurable interest on the insured.[113]

In spite of the numerous uncertainties and arguments as to its precise scope, it is submitted that certain types of relationship can be covered under the second paragraph of article 52:

(1) creditor and debtor

(2) employment relationship;

(3) partnership.

In these relationships, a person is presumed to have an insurable interest in the other's life, as he has a pecuniary interest with the other.

A creditor, for instance, has an insurable interest in the life of his debtor, because if the debtor dies before he repays the creditor the debt, the creditor might not get the money back and is likely to suffer a financial loss. A creditor has a lawful right to demand the debtor to fulfil his obligation,[114] so he has also a legally recognised interest to effect a policy on the life of his debtor against the risk that the debtor may fail to clear out his debt before his death. This kind of insurance must be made with the agreement of the debtor and the sum insured must be limited to within the amount of the debt, and the creditor shall be designated as the beneficiary by the debtor in the policy.

The same is no doubt true for an employment relationship and business partnership. The insurable interest in these relationships is usually reciprocal. In other words, the employer and employee can take out insurance on each other. It is the same in the relationship of business partners. This kind of policy, however, can be effected only upon the consent of the life insured and the sum insured must be approved in writing by the life insured.[115]

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[113] Xu Xuelu, Baoxianfa (Insurance Law), p. 53, 2000; Bian Yaowu, Zhonghua Renmin Gongheguo Baoxianfa Shiyi (The Interpretation on the Insurance Law of the PRC), p. 107, 1996; see also Sun Jilu, Baoxianfa Lun (Discussion on Insurance Law), p. 71, 1997. He said: If the life insured has agreed that the proposer can effect a policy on his life, the later is presumed to have an insurable interest on the life insured. In practice, the following relationships fall into the category. (1) a legal person on its employees; (2) an employer on his employee; (3) a creditor on his debtor; (4) common owners of a property on the person who has an obligation to take care the property; and (5) a guarantor on the debtor.

[114] Art. 84 of the Civil Law 1986 (PRC).

[115] Art. 55 of the Insurance Law.

The approach of English law is similar to Chinese law as to these relationships. Under English common law, it has long been established that a creditor has an insurable interest in the life of his debtor.[116] It has been held that on the debtor's death the creditor loses his right of action against the debtor, and this loss is sufficient to support the insurance even though the debtor's estate is solvent and there is an abundant prospect of the debt being ultimately paid in full.[117] The creditor has an insurable interest at least to the amount of the debt and interest due thereon at the time the inception of the policy.[118] The right of a debtor to insure the life of his creditor was discussed in *Hebdon v. West*.[119] This case also illustrates the point that an employee may effect a policy on his employer's life. In this case, an employee effected two policies on his employer's life with two insurers, one was for £5,000, the other for £2,500. The employee was a bank clerk, and he had a contract to serve his employer for seven years at a salary of £600 per annum and was also a debtor of is employer for £4,700 which the employer had promised not to call during the latter's lifetime. The employee therefore insured his employer's life on the two grounds. It was held that the employee had an insurable interest in his employer's life only up to the amount of his salary which would be paid during his employment and he had no insurable interest in the employer's life for his promise not to call the debt as the promise was not legally enforceable and was insufficient to sustain an insurable interest. On the same rationale, partners have an insurable interest on each other's life up to the amount of loss which might potentially be caused in the event of the death or retirement of a partner.[120]

A similar approach can be found in the Australian ICA 1984. Section 19(4)(a) provides that a body corporate has an insurable interest in the life of an officer or employee of the body corporate and section 19(4)(b) states that an employer has an insurable interest in the life of his employee and an employee has an insurable interest in the life of his employer. Section 19(3) contains the cases that a creditor has an insurable interest in his debtor's life and a partner has an insurable interest in his

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[116] *Anderson v. Edie* (1795) 2 Park (8th ed. 1842) 914.
[117] See MacGillivray on Insurance Law, (9th ed.), para. 1-83, 1997.
[118] *Law v. London Indisputable Life Insurance Policy Co.* (1885) 1 K. & J. 223.
[119] *Hebdon v. West* (1863) 3 B. & S. 579; 122 E.R. 218.
[120] *Griffiths v. Fleming* [1909] 1 K.B. 805.

partner. However, it should be noted that the amount of interest is not limited in this Act.[121] It has been submitted that the retention of the concept of insurable interest in section 18 of this Act reflects a continuing social concern with the temptation of an insured to murder the life insured. Making the insurable interest unlimited seems to involve some resiling from the purpose of the retention.[122] The question of limitation of insurable interest will be discussed later.

3.5 Matters in respect of insurance beneficiary

In China, up to now, in the life insurance business, arguments have been focused on the issue of the beneficiary. Among them the strongest arguable question is who is the beneficiary when the life insured dies. To solve this problem, the Insurance Law puts several provisions between article 60 and article 64 as well as article 21 which give detailed stipulations relating to the matters of the beneficiary, but they do not completely solve the problems often entertained in practice. There are at least four problems needing to be discussed here: (1) Whether or not the beneficiary's name needs to be entered into the policy; (2) If the beneficiary's name was not put into the policy, who has the right to enjoy the insurance moneys; (3) Must the permission of the life insured be required where the proposer designates or changes the beneficiary; (4) Whether or not the beneficiary is required to possess an insurable interest. Let us deal with these four questions one by one.

(1) Whether or not the beneficiary's name need to be inserted into the policy

The Insurance Law does not make it clear whether or not the name or names of the beneficiary or beneficiaries must be inserted into the policy, but an implication of this requirement might be discerned in some articles. Articles 60 and 61 stipulate that the beneficiary or beneficiaries should be designated by the life insured or the proposer, and if there are two or more beneficiaries, the life insured or the proposer may determine the sequence in which they shall receive benefits and the amount of benefits. Article 62 provides that the insured or the proposer may change the

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[121] S.19(5) declares that "where a person has an insurable interest in the life of some other person, the amount of that interest is unlimited."
[122] See A.A. Tarr, *Insurable interest,* [1986] A.L.J., p. 617.

beneficiary and, in this case, he shall notify the insurer in writing and the insurer shall make an endorsement in the policy in accordance with the written notice. It could be submitted that these articles imply that the name or names of the beneficiary or beneficiaries should be inserted into the policy. The law does not render the policy illegal or null if the life insured or the proposer failed to designate the beneficiary in the policy. Article 62 of the Insurance Law retains the validity of the policy and requests the insurer to pay the insurance moneys to the insured's successors where no beneficiary or beneficiaries have been designated.[123] Due to the reason that the Insurance Law does not expressly and strictly require the name or names of the beneficiary or beneficiaries to be inserted into the policy, it often happens in practice that the life insured or the proposer have, either deliberately or negligently, left the space blank and no beneficiary or beneficiaries have been designated in the policy. This fact causes lots of arguments among the family members of the life insured for claiming the insurance moneys upon the death of the life insured. Difficulties have been caused for the insurance companies or courts in determining who should be the beneficiary or beneficiaries under these circumstances.

By comparison, English insurance law is much stricter than Chinese insurance law in this respect. In section 2 of the LAA 1774 (UK), it requires that the names of the insured and any beneficiary must be inserted in the policy, otherwise the policy shall be illegal. Opposite views have been pointed out by a commentator on this strict requirement which suggested that section 2 of the LAA 1774 is superfluous.[124] Australian law does not adopt the 1774 Act approach that the name or names of beneficiary or beneficiaries must be inserted into the policy. Section 20 of the Australian ICA 1984 states: "An insurer under a contract of insurance is not relieved of liability under the contract by reason only that the names of the persons who may benefit under the contract are not specified in the policy document." However, section 20 does not give a positive solution of how to dispose of the insurance moneys if the name or names have not been specified in the policy.

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[123] English insurance law strictly stipulates that the name or names or the beneficiary or beneficiaries must be inserted in the policy, otherwise the policy shall be unlawful or illegal. See s.2 of the LAA 1774 (UK).

[124] See J. Birds, Modern Insurance Law (4th ed.), pp. 45-47, 1997.

Despite the different approaches, it is suggested that if the beneficiary is an individual, his/her name should be inserted into the policy for the reasons which will be discussed soon. If the beneficiaries fall into a group or a class, the solution set up in section 50 of the Insurance Companies Amendment Act 1973 (UK)[125] may be adopted which provides that section 2 of the LAA 1774 (UK) does not invalidate a policy for the benefit of unnamed persons from time to time falling within a specified class or description if the class or description is stated in the policy with sufficient particularity to establish the identity of all persons who at any given time are entitled to benefit under the policy.

(2) If the beneficiary's name has not been inserted into the policy, who should have the right to enjoy the insurance moneys?

Article 63 of the Insurance Law is in an attempt to solve this problem; however, not only has it not solved the problem but it has made it even worse. Many arguments arise from this article. Article 63 is in the following terms:

"Upon the death of the life insured, the insurance moneys shall become part of the life insured's estate, and the insurer's obligation to pay insurance moneys shall be performed in favour of the life insured's successors under any of the following circumstances:

(1) where no beneficiary has been designated;

(2) where there is only one beneficiary, and such beneficiary dies prior to the death of the insured; or

(3) where there is only one beneficiary, and such beneficiary loses or waives his beneficiary right according to law."

The first situation, *i.e.* no beneficiary has been designated, may be caused by three reasons:

(a) No beneficiary was designated when the policy was effected;

(b) One or more beneficiaries were designated when the policy was effected, but the life insured or proposer intended to change the beneficiary or beneficiaries during the currency of the policy and the original beneficiary or beneficiaries were

[125] 1973. C.58.

cancelled, but, before the death of the life insured, other beneficiary or beneficiaries were not designated. So, factually, there was no beneficiary specified in the policy when the life insured died;

(c) The beneficiary was designated ineffectively. The designation of the beneficiary is ineffective where it is made by a person without civil act capacity or by the proposer who has not obtained the consent of the life insured.[126]

Article 63 (2) means that if the beneficiary named in the policy dies before the death of the life insured, and no other beneficiary is designated by the life insured or the proposer, the insurance moneys would be disposed of, upon the death of the life insured, as part of the deceased's estate which would be paid to the deceased's successors. Where the beneficiary named in the policy dies soon after the death of the life insured, but before obtaining the insurance moneys, the insurance moneys shall be paid to the beneficiary's successors.

Article 63(3) has a double meaning, one meaning is that the beneficiary shall lose his beneficiary right where he deliberately causes the life insured to die, or become disabled, injured or sick. The other meaning is that the beneficiary waives his right of recovering the insurance moneys from the insurer after the death of the life insured and so the insurance moneys shall also be disposed as the deceased's estate.

No matter what may cause the situation that there is no beneficiary being designated in the policy, or where there is a class of beneficiaries being determined but not being named, the important thing is how to dispose of the insurance moneys under this circumstance. Several examples may illustrate this problem. The first example is that of where there is no beneficiary being designated at all. For example,[127] in a case, an employee was insured under a personal accident policy taken out by his employer, but no beneficiary was designated in the policy and the space of the beneficiary was left blank. When the insured died in an accident, both his employer and his wife claimed against the insurance company for the insurance proceeds. The insurance company settled this case according to article 63(1), and paid the insurance moneys to the life

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[126] See the Chinese case *Cai Shi-gen, etc v. Xiamen Life Insurance Co.* "Selected Cases of the People's Court of China", vol. 2, P.132, 1993. This case will be discussed in detail later.

insured's successors. Under this circumstance, the deceased insured's debts, if any, shall be cleared off first from the insured's estate (including the insurance moneys).[128] So in this case, the insured's wife and his mother recovered the insurance moneys as the insured's successors.[129]

However, a more difficult question under this circumstance arises where the insured's legal successors are different between the time when the policy was effected and the time when the insured died. A case illustrated this problem.[130] A mother effected a life insurance policy on her son's life. No beneficiary was designated in the policy when the policy was effected. Obviously, this case constituted a same situation to the above case, *i.e.* the insurance money should be paid to the insured's legal successors after deducting the insured's debts. However, the problem was that when the policy was effected by the insured's mother, the insured was not married, his successor was his mother only, but when the insured died, his successors were his wife and his mother. Both of them claimed for their own benefit. The wife claimed that she was her husband's legal successor and so she was one of the legal beneficiaries. The mother argued that she herself was the proposer of the policy and she paid the premium for it. When the policy was effected the insured had not been married, and therefore she should be the only legal beneficiary of the policy. The mother also argued that according to article 62 of the Insurance Law, if the insured had intended to change the beneficiary, he should have given a written notice to the insurance company, but, when he died, he had not done this. So she thought that the insured's wife should not be included in the categories of the insured's legal beneficiaries. It was decided in the People's High Court, by rejecting the lower court's decision, that the insured's wife had a right to share the insurance moneys as one of his legal beneficiaries.

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[127] See Lei Jian, *Shui shi shou yi ren (Who is the beneficiary)*, China Insurance, No.8, p.23, Beijing, China, 1999.

[128] Art. 33 of the Inheritance Law 1985 (PRC) states: "The inheritance of the estate shall be performed after the payment of the deceased's taxes which he would have paid before he died and of the deceased's debt...." This means that the deceased's net estate shall be inherited by his successors.

[129] According to the Inheritance Law 1985 (PRC), art.10, spouse, children and parents are the first sequence of the successors. In this case, the insured had no child and his father had died, so his wife and his mother were his legal beneficiaries.

[130] This case was reported on the *China Insurance News*. June 1, 1999.

It is submitted that the key issue of this kind of case is how to ascertain the legal beneficiaries as a matter of time, in other words, whether the legal beneficiaries shall be determined at the inception of the policy or at the death of the life insured where there is no beneficiary designated during the currency of the policy. It is inferred on the basis of article 62 (1) of the Insurance Law and the Inheritance Law of 1985 (PRC)[131], that the legal beneficiaries should be ascertained at the time when the insured died simply because only from that time does the insurance money become part of the insured's estate. So the insured's wife should fall into the categories of the legal beneficiaries. However, this inference seems not to meet the intention of the proposer and the life insured who effected the policy for the purpose of protecting only the persons who fell into the category at the inception of the policy.

There is a similar but more complex example.[132] An insured effected a policy in his own life, designated his wife as the beneficiary, but failed to insert his wife's name in the policy, only put a word "wife" in the policy as the beneficiary. The insured later divorced his wife and remarried to another woman. When the insured died, his ex-wife and his new wife both tried to claim for the insurance money from the insurance company. Who has the right to get the insurance money? This is very similar to the above example. By law his new wife should benefited from the insurance, because, after the divorce, the ex-wife had no legal relationship with the life insured and she was not the wife of the insured,[133] so she had no right to recover. However, this was not the original purpose for the life insured to take out insurance under which his ex-wife was to be the beneficiary. Furthermore, if by taking the English common law as reference that insurable interest is required only at the inception of the policy,[134] it could be inferred that the determination of the beneficiary should be made in correspondence with the situation and the intention of the insured at the time when the policy was effected. This is really a awkward question to deal with. In order to avoid

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[131] The Inheritance Law of the PRC was enacted in 1985. In art. 3, it is states: "The inheritance shall begin from the time when the predecessor dies."

[132] See Li Baoming and Ju Weihong, *Lun Shouyiren De Ruogan Falu Wenti (The problems about life insurance beneficiaries)* Insurance Studies, No. 7, pp. 39-41, Beijing, China, 1998.

[133] See the Marriage Law, art.24.

[134] *Dalby v. India and London Life Assurance Co.* (1854) 15 C.B. 365. This case will be fully considered later. See also MacGillivray on Insurance Law, (9th ed.), para. 1-114, it is stated: "... If the person interested is so referred to in the policy as to be capable of being ascertained at the date when the policy was effected it is probably immaterial that the actual name is not inserted. In the widest sense a person's name is any label which indicates that person as the person who is referred to."

or reduce the argument about the beneficiary, it is suggested that in a situation similar to the above two examples, the beneficiaries should be the insured's legal successors who are qualified by the Inheritance Law at the time when the insured dies. It is also suggested that, in practice, the proposer should be required to insert the name of the beneficiary or beneficiaries or give a description of the beneficiary or beneficiaries as clearly as possible.

(3) Must the permission of the life insured be required where the proposer designates or changes the beneficiary?

Article 60 of the Insurance Law states: "The beneficiary of personal insurance shall be designated by the insured or the proposer. The consent of the insured shall be required when the proposer designates a beneficiary." Two cases are involved here: (1) where the proposer effects a policy on another person's life for his own benefit, the proposer and the beneficiary is the same person. In this case, the life insured may designate the proposer as a beneficiary. If the proposer designates himself as a beneficiary, he must obtain the permission of the life insured. (2) where the proposer effects a policy on the other's life for a third party's benefit, the proposer, the life insured and the beneficiary are different persons. Under this circumstance, the beneficiary can be designated either by the life insured or the proposer. Where the proposer designates a beneficiary, he must have the consent of the life insured.[135] In both situations, the designation will be void without the permission of the life insured.

A Chinese case illustrated this. *Cai shi-gen, et al. v Xiamen Life Insurance Co.*[136] The plaintiffs were the legal successors of the life insureds who were the employees of the Xiamen Ocean Fishing Company and died in an accident. In Feb. 1989, Xiamen Ocean Fishing Co. took out a group life insurance for its employees with the Xiamen Life Insurance Company. The proposer orally designated the company itself as the beneficiary without the consent of the life insureds. The insurer agreed on the proposer's doing so. One month later, 21 of the life insured employees were drowned when the fishing ship sank in the sea. The insurer soon paid the insurance moneys to the proposer, the Ocean Fishing Company, in accordance with the agreement of the

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[135] Art. 60 of the Insurance Law.
[136] See Selected Cases of the People's Court of China [1993] vol. 2, p.132.

insurance contract. The plaintiffs, as the deceased's successors, took a legal action against the insurer in the Xiamen People's Court. It was held that, the proposer designated itself as the beneficiary without the consent of the life insureds, so the designation was void. It was treated as a situation in which no beneficiary had been designated. The legal successors of the deceased had the right to receive the insured moneys in accordance to article 63 (1) of the Insurance Law.

Article 62 provides that "The life insured or the proposer may change the beneficiary and in this case he shall notify the insurer in writing. Upon receipt of a written notice of a change of beneficiary, the insurer shall endorse the policy." Nevertheless, if the change of beneficiary is made by the proposer without the permission of the life insured, the change is unenforceable. This is proved by the case of *Li Xiao Xin v. The PICC Jize Branch.*[137] In 1994, a steel factory took out group life policies on the behalf of its workers. There were no beneficiaries being designated when the policies were effected, but later the director of the factory put the director himself as a beneficiary in one of the workers' policies and the insurance company agreed. The worker died in an accidental explosion in a workshop, and the director of the factory recovered the insurance money under the policy. The insured's wife made a legal action against the insurance company on the ground that when the policy was effected, no beneficiary had been designated, according to cause 11 of the Group Personal Accident Insurance,[138] she, as the insured's legal successor, should become the legal beneficiary upon the death of her husband. It was held that, as the director changed the beneficiary without the consent of the insured, this change was void. The insured's wife had the right to recover the insurance money.

It is clear from these cases that the proposer is allowed to designate or change the beneficiary for a life policy, but this right must be exercised with the consent of the life insured. Otherwise the designation or change of the beneficiary is void.

(4) Whether or not the beneficiary is required to possess an insurable interest

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[137] See Leading Cases Reports of the People's Court of China, vol. 1, p.121, 1998.
[138] See the Group Personal Accident Insurance of the PICC, Clause 11. Before the enactment of the Insurance Law 1995, this clause was effective.

The Insurance Law does not provide whether or not a beneficiary must have an insurable interest for a valid policy. The law only requires the proposer to have an insurable interest in the life of the life insured, otherwise the policy is void.[139] However, as was just discussed above, the beneficiary should be designated by the life insured, and where the proposer designates a beneficiary the consent of the insured must be acquired.[140] It is obvious that the consent of the insured is very important for a person to become a beneficiary, as long as the insured agrees, that person is the qualified beneficiary without being required to have an insurable interest.

Generally, there are two types of life insurance. One refers to the policies by which the insurer is required to give the insurance moneys to the insured himself where the insured is alive to the fixed date determined in the policy, such as in annuity or endowment insurance. Under this type of insurance, the beneficiary is, usually, the insured himself who effects the policy for his own benefit. He will get the insurance money when he reaches the fixed date or agreed age, and so this type of policy may not cause moral risk for the life insured. The other type of life insurance concerns the policies by which the insurer shall pay the insurance money to the beneficiary upon the death of the life insured. The beneficiary under this type of insurance is usually another person or persons other than the life insured. This type of insurance may become an inducement to the beneficiary or beneficiaries to murder the person whose life is insured if there is no strict limitation imposed on the qualification of the beneficiary. The requirement of insurable interest on a beneficiary becomes meaningful only in the later case. So it is submitted that a beneficiary of an insurance contract in which the death of the life insured is set as the condition for payment of the insurance moneys should have an insurable interest in the life of the life insured. The reasons are as follows:

(a) If a person who has no interest in the life of the life insured is allowed to get benefit from the insurance money upon the death of the life insured, it amounts to the fact that the person can make profit by the means of insurance which is against the nature of the insurance by which the beneficiary can not recover if he has not suffered any economic loss. Although in life insurance, the amount paid by the

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[139] Arts. 11 and 52 of the Insurance Law.
[140] Art. 60 of the Insurance Law.

insurer is not exactly the economic loss suffered by the beneficiary, there should be *an* economic loss as a result of the death of the life insured.

(b) In the situation where the proposer and the beneficiary are not the same person, the requirement of the insurable interest imposed upon the beneficiary is more important than that upon the proposer, because the beneficiary would get the benefit from the insurance money rather than the proposer.

(c) It is not denied, in practice, that a beneficiary who has an insurable interest may murder the life insured for the insurance money, *e.g.* a husband murder his wife or vice versa or a parent murder his child for obtaining an insurance money, but it, after all, rarely happens.

(d) Although, by law, the beneficiary shall be designated by the life insured or the proposer with the permission of the life insured, it might be the case that, when the policy is effected, the life insured designates one of his good friends as the beneficiary, but, due to the attraction of the insurance money, it is not surprising that the friend afterwards may murder the life insured.

By the analysis above, it is suggested that a beneficiary should possess an insurable interest in the life of the life insured in addition to the consent of the life insured.

3.6 Contradiction of the provisions in the Insurance Law 1995 (PRC)

It is not difficult to note that articles 11, 52 and 55 of the Insurance Law are contradictory. By the meaning of article 11, a proposer must have an insurable interest in the life of the life insured, but in the second paragraph of article 52, it provides that the life insured's consent only is sufficient to constitute an insurable interest where a person effects a life policy on the life insured. Again, article 11 defines the insurable interest as an interest legally recognised, but, by virtue of the second paragraph of article 52, a legally recognised interest is not necessary, the proposer can effect a policy on the life of the life insured as long as he obtains the life insured's consent.[141]

[141] How to test an insurable interest is another question which will be discussed later.

On the other hand, by the second paragraph of article 52, it appears that persons who fall into the categories of the first paragraph of article 52 do not need to obtain the consent of the life insured when they take out a life insurance on him. However, the first paragraph of article 55 requires any person who effects a death policy on the life insured to get the written consent of the life insured and the sum insured must be agreed by the life insured in writing; failure to satisfy these conditions renders the policy void. It is obvious that article 55 does not exclude the persons described in the first paragraph of article 52 who have an insurable interest in the life of the life insured. This makes the first paragraph of article 52 absolutely superfluous.

However, there are different understandings of the meaning of the second paragraph of article 52. Some writers insist that the proposers mentioned in this paragraph refer to only the persons who have an economic relationship with the life insured but does not mean any other person. For instance, a creditor is deemed to possess an insurable interest in his debtor's life where he can show the debtor's consent, also the relationship of employer and employee or a partner and another partner, and so on.[142] Some others consider that the proposer mentioned in this paragraph is no more than an agent who concludes a contract with an insurance company on the behalf of the life insured upon the consent of the insured.[143] In the absence of any judicial explanation, it is difficult to have a definite answer on the question who the proposer would be. Personally I would suggest that the proposer mentioned in this paragraph refers to any person who gets the permission of the life insured. If this suggestion is correct, it seems that the Insurance Law produces two criteria, one is "the requirement of the evidence of the life insured's consent";[144] the other is "the requirement of insurable interest plus the consent of the life insured"[145]. These two inconsistent criteria should not co-exist in the Insurance Law. Thus the next question is which approach should be retained in the Law. It is suggested that the second approach is desirable.

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[142] See Liu Dongjiao, *Renshen Baoxian De Baoxian Liyi (The Insurable Interest in Life Insurance).* In: the Application Book of the Insurance Law, p. 357, 1996; Bian Yaowu, Zhonghua Renmin Gongheguo Baoxianfa Shiyi (The Interpretation on the Insurance Law of the PRC), p. 107, 1996. See also Xu Xuelu, Baoxianfa (Insurance Law), p. 53, 2000.

[143] See Zhou Yongsheng, Baoxian He Falu (Insurance and Law), (2nd ed.), p.123, 1998.

[144] Art. 52, para. 2 of the Insurance Law.

[145] *Ibid*, para. 2 of art. 52 and para. 1 of art.55.

It is clear that the provisions of the Insurance Law in respect to the insurable interest in life insurance reflect two features. First, the law stresses the family relationship. Paragraph one in article 52 provides that a person has an insurable interest on his own life, on the life of his spouse, children, parents and other members of his family on whom he depends. Article 63 stipulates that in some special situations, the insurance moneys shall be disposed of as the life insured's estate and paid to the life insured's successors. This feature is responding to the characteristic that family members have a legal obligation to support or provide maintenance to each other.[146] Once the life insured dies, the other members who are supported by him would suffer an economic or pecuniary loss, and they are, therefore, presumed to have an insurable interest on the life of the life insured.

Secondly, the law reflects the feature of the requirement of the insured's consent. The second paragraph of article 52 provides that a proposer is presumed to possess an insurable interest in the life of any third person upon the third person's permission being given. Article 55 renders a policy null and void where the policy is effected without the written consent of the life insured on the conclusion of the contract and the approval of the sum insured. Article 55 also prohibits a life policy to be assigned or mortgaged without the life insured's consent in writing. Also, article 60 gives the right to the proposer to designate a beneficiary, but the consent of the insured is required when the proposer designates a beneficiary. Article 62 stipulates both the insured and the proposer may change the beneficiary during the currency of the policy, but, if it is made by the proposer, the consent of the life insured must be obtained. The second feature represents a major step forward to protect the life insured from moral risk. However, the second feature renders the first one completely superfluous. Because, by the second feature, any person, whether or not he has an insurable interest in the life of the life insured, can effect a policy on the life insured upon the consent of the life insured,[147] and any person, whether he has an insurable interest or not, must obtain written permission of the life insured where a policy is effected in which the death of the life insured is the condition of the payment of the insurance money. In this sense, the family members of the insured who are presumed to have an interest in the life

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[146] See arts. 14-23, Marriage Law 1980, or arts. 20-30 of the amended Marriage Law 2001.
[147] Art. 52, para. 2 of the Insurance Law.

insured, have the same right as those who have no insurable interest in the life insured, but only with his permission, to take out insurance on the life insured.

This confusion may be solved by deleting the second paragraph of article 52, leaving the first paragraph of article 52 (but widening the list) and article 55 operating together, *i.e.* a proposer is required to have both an insurable interest on the life insured and a consent of the life insured when a contract is concluded in which the death of the life insured is set as a condition of the payment of the insurance money. Thus the life insured shall be doubly protected from the temptation of murder. Alternatively, the first paragraph of article 52 may be deleted and the approach of the requirement of the insured's consent should be adopted. In my opinion, the first approach should be retained which gives the life insured more protection and gives economic help to the persons who really suffer economic loss upon the death of the life insured. However, the alternative criterion of the consent of the life insured is adopted in some other jurisdictions[148] instead of the requirement of insurable interest.

3.7 When insurable interest is required in life insurance

There is no an express provision dealing directly with this question in the Insurance Law. However, under article 11, the possession of an insurable interest by the proposer is a pre-condition for concluding a valid contract. It could be submitted that this article requires the proposer to have an interest at the time of the conclusion of the contract. In England, s. 1 of the LAA 1774 makes an insurance contract null and void if the insured has no insurable interest in the life of the life insured when the contract is concluded. The Australian ICA 1984 s.18 expressly requires the insured to possess an insurable interest in the life of the life insured when the contract is effected where he takes out a contract of life insurance or a contract that provides for the payment of money on the death of a person by specified sickness or accident. Otherwise the contract is void. From these provisions, it is clear that in all these three countries, the insurance laws require a proposer to possess an insurable interest in the life of the life insured at the inception of the policy.

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[148] It was noted that this approach has been adopted in certain other jurisdictions, such as France (c, ass., Art. 132-2,) Germany (VVG, Art.159), Ontario (RSO, 1980, s.155(2)(b)), Switzerland (Loi federale sur le Contrat d'Assurances (LCA) Art. 74) and the State of New York (Ins. Law, sect. 146(3)).

However it is not clear whether or not the insurable interest has to last during the currency and must exist when the insured event occurs. Some provisions of English law and Australian law imply that insurable interest is required at the time of loss. Section 3 of the LAA 1774, talking as it does in terms of the insured recovering only the value of his interest, might be thought to require interest at the time of loss, *i.e.* at the death of the life insured.[149] Section 19(3) of the Australian ICA 1984 prescribes that a person is presumed to have an insurable interest if he is likely to suffer pecuniary loss as a result of the death of the life insured. Both the sections imply that insurable interest is required at the death of the life insured. There is no such an implication in the Insurance Law (PRC).

In English common law, it was decided in some cases that the insurable interest had to exist when the life insured dies. This was the decision in the old case of *Godsall v. Boldero*,[150] in which a creditor, being owed over £1,000, insured the life of his debtor for £500. The debtor died insolvent but nevertheless the debt was satisfied by his executors from funds granted by Parliament for this purpose. The creditor then brought an action on the policy. It was held that a contract made by the creditor in the life of his debtor is substantially a contract of indemnity against the loss of the debt, if, after the death of the debtor, his executors pay the debt to the creditor, the creditor cannot afterwards recover upon the policy. However, this decision was overturned in the landmark case of *Dalby v India & London Life Assurance Co.*[151] which has stood unchallenged for well over a century and which established beyond doubt that it is necessary for the insured to have an interest only at the time the policy is effected. *Dalby*'s case was an action upon a policy of life insurance effected by Anchor Life Assurance Co. on the life of the Duke of Cambridge. That was in fact a reinsurance case. The plaintiff was the manager of Anchor Life Assurance Co., which had insured the life of the Duke of Cambridge, and then reinsured partial risk with the defendant, India and London Life Assurance Co. The original policy was cancelled. The Anchor Life had no further interest in the Duke's life, but the manager of the Anchor Life kept paying the premiums on the reinsurance policy until the Duke died. The defendant

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[149] See John Birds, Modern Insurance Law, (4th ed.), p.38, 1997.
[150] (1807) 9 East 72; 103 E.R. 500, followed in *Henson v. Blackwell* (1845) 4 Hare 434.
[151] (1854) 15 C.B. 365.

then denied liability on the ground that the Anchor Life had no interest in the Duke's life at the date of his death. The Exchequer Chamber held that the plaintiff Dalby, acting as trustee for the Anchor Life, was entitled to recover the money they agreed. It was held that the LAA 1774 required proof of interest only at the date when the policy was effected, and the policy itself, not being a contract of indemnity, required no proof of interest at the time of loss.

The decision of the *Dalby* case, although it has received a lot of criticism,[152] seems to be accepted universally in practice. In spite of the absence of any statutory provision incorporating it, the decision in *Dalby* has been adopted as a rule in insurance practice in China.[153] There was a similar decision in a Chinese case.[154] A woman took out a life insurance on the life of her father-in-law, and she designated her 8 year old son as the beneficiary (the woman was presumed to have an insurable interest on the life of her father-in-law at that time). Two years later, the couple (the woman and the life insured's son) divorced, but she kept paying the premium for the policy until her former father-in-law died. It was held that she was entitled to recover as her son's legal agent, because the interest existed when the policy was effected although the proposer did not have the interest at the time when the life insured died.

The decision of *Dalby* case has been also accepted in theory by most Chinese scholars. Li Yuquan said: "In life insurance, (1) the insurable interest must exist when the contract is concluded. If the proposer has no close relationship with the life insured, it may cause moral hazard, and the life insured may be in the danger of murder. (2) The insurable interest is not necessary to exist when the insured event occurs, because life policy has the feature of savings, the money paid by the insurer to the beneficiary is, in fact, the accumulation of the proposer's premium and interests. If the proposer (if he is the beneficiary) is not allowed to recover the insurance money due to the fact that he

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[152] See John Birds, Modern Insurance Law, (4th ed.), p.40. See also R. Merkin, *Gambling by insurance - a study of the Life Assurance Act 1774*, 9 Anglo-American L.R. 331.

[153] In judicial practice, usually, the court judges refer to international convention (international customary practice) or other countries' leading cases to make judgement where there is no law to be followed in Chinese statutes.

[154] See Hu Wenfu, "Baoxian Lipei Suopei Zhinan" (the guidance of insurance claim and settlement), p. 86, 1993.

has no insurable interest at the time when the life insured dies, it is no doubt that his rights and interests will be in the status of uncertainty."[155]

However, the decision in *Dalby* may cause mischievous consequences which have received criticism. A man, for instance, insures his wife for his own benefit. He divorces his wife afterwards, and remarries to his new lover, but he has the right to continue the policy until his former wife dies under the decision of the *Dalby* case. Similarly, where a creditor effects a policy on his debtor's life for the amount of his debt, the debt may be repaid shortly thereafter, yet, under *Dalby's* decision, the creditor may keep up the policy until the death of his debtor, which may be many years later. It is quite possible that a moral risk may occur under this circumstance. In addition, there is a strong element of gaming or wagering. So it is submitted that the requirement of insurable interest should be required at the time of the loss. Some suggestions could be made as follows: (1) Once the proposer ceases to have an interest in the life insured, the latter should have the option of taking over the policy for his own benefit, subject to some compensation to the proposer in respect of the premiums he has paid; (2) Once the proposer ceases to have an interest in the life insured, he should notify the insurer to terminate the policy and the insurer should refund the surrender value of the policy to the proposer.

3.8 The effect of a policy without interest on the life insured

The second paragraph of article 11 of the Insurance Law provides that "An insurance contract shall be void where the proposer has no insurable interest in the insured subject matter". In spite of the fact that the purpose behind the introduction of article 11 is to prevent gambling on the other's property or on the other's life, the law imposes no penalty for the contravention of the provision. The law does not make it an offence for a person to enter into a contract of insurance in which he has no interest or for an insurer or his agent who agree to honor such policy, the law merely declares such a contract of insurance to be null and void. Under a null or void contract, the remedy is to return the premium to the proposer by the insurer after deducting the

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[155] See Li Yuquan, Baoxianfa (Insurance Law), pp. 81-82, 1997. Others have the similar points of view, see also Xu Xuelu, Baoxianfa (Insurance Law), p. 54, 2000 and Sun Jilu, Baoxianfa Lun (the Discussion on Insurance Law), p. 72, 1997.

expenses. Because of the lack of legal punishment in the Insurance Law for parties who conclude an insurance contract under which the proposer has no interest, it might cause the situation in which the insurer or proposer deliberately effect such a contract in a chance to get premium for the insurer's purpose or to make profit for the proposer's purpose. In order to find a solution, it is helpful, at this stage, to see how English law solves this problem. As was noted earlier, in England, matters relating to insurable interest in life insurance are governed by the LAA 1774. Sections 1 and 2 give different effects to a policy without an interest. Failure to comply with s.1 renders the policy merely null and void, but the contravention of s.2 renders such a policy illegal. This difference between a contract of insurance which is simply void and the contract which is illegal concerns not its enforcement, but the availability of restitution of premiums. Under a void contract premiums are recoverable for a total failure of consideration,[156] but under an illegal contract, the general rule is that the insured can recover neither the policy moneys nor the premiums which he has paid.[157] However, in some certain circumstances, the insured may recover premiums notwithstanding the illegality of the insurance. In the leading work of MacGillivray on Insurance Law[158] these circumstances are summarised as follows:

(a) Where the insured has been induced to contract by the fraud of the insurer or his agent;
(b) Where the illegality arises from the form of the policy as issued by the insurers;
(c) Where the insured was ignorant of the facts which made the insurance illegal;
(d) Where the insured claims rescission of the contract before the risk has attached;
(e) Where, in the case of statutory illegality, the statute is intended to protect insureds as a class so that they are not to be regarded as *in pari delicto*;[159]
(f) Where the insured has a right of recovery conferred by statute.

The (a) and (c) exceptions are applicable to insurable interest cases, and raise notable issues.

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[156] Cf. MIA 1906, s. 84, although recovery is denied where the policy was made by way of gaming or wagering: MIA 1906, s. 84(3)(c).
[157] The authorities are *Howard v. Refuge Friendly Society* (1886) 54 L.T. 644; *Harse v. Pearl Life Assurance Co.* [1904] 1 K.B. 558.
[158] See MacGillivray on Insurance Law, (9th ed.), p.191, para. 8 -11, 1997.
[159] According to the law dictionary, the term "*in pari delicto*" [L] means parties are in equal fault.

In England, the first conclusive authority on the interpretation of LAA 1774, section 1 was *Harse v. Pearl Assurance*[160], in this case it was decided that a breach of s.1 does render a policy illegal, and settled this according to the general rule on illegal policy based on the maxim of *pari delicto potior est conditio defendentis*. In this case the insured was wrongly advised by an insurer's agent to effect a policy on the life of the insured's mother on whom he had no interest. It was held that on her death the insured could recover neither the sum insured nor the premiums. In the view of the Court of Appeal, the wording of LAA 1774, section 1 was sufficiently indicative of an intention to impose the illegality sanction to life insurances without interest.

However, as far as the improper conduct of an insurer's agent are concerned, the English cases are somewhat conflicting. In *British Workmen's & General Assurance Co. v. Cunliffe* [161] the decision in this case which was made just two years earlier than that in *Harse* was quite different. In *Cunliffe* an agent of the insurers induced the insured to effect a policy on the life of his brother-in-law, in which he had no insurable interest. The Court of Appeal decided that the insured was entitled to recover the premium on the ground that the agent's conduct was sufficiently improper, although it could not constitute a fraud, as he knew what the law was and that the insured had no insurable interest, and despite this, concluded the contract.

Cunliffe and *Harse* were similar facts but reached conflicting results. The focus in the conflict was on what was the degree of the agent's improper conduct which could be regarded as a fraudulent conduct. For it is doubtlessly true that if there is no element of fraud or trickery on the part of the insurer or his agent, the parties will be *in pari delicto*, since it is a general principle that every one is presumed to know the law, and the premium is unrecoverable. If the insurer or his agent does it fraudulently, the exception of the rule of *in pari delicto* for an illegal contract applies, and the premium is recoverable.[162] However, in practice it is hard to determine to what degree the principle of *in pari delicto* may apply to the improper conduct on the part of the insurer or his agent. So the sort of fraud required to give rise to an exception to the *in pari delicto* rule will be generally hard to establish. However, in England, it is

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[160] [1904] 1 K.B. 558.
[161] (1902) 18 T.L.R. 502.
[162] *Hughes v. Liverpool Victoria Legal Friendly Society*, [1916] 2 K.B. 482.

probable that in a modern setting both law and practice are more generous to an innocent insured who has been misled by a negligent agent, or even by an insurer who simply issues a policy without bothering to check the precise relationship of the assured with the life insured. Several reasons are summarised by Professor R. Merkin in his Insurance Contract Law.[163] The English Insurance Ombudsman was reluctant to adopt the decision of *Harse* and he stated that *Harse* probably no longer represents the law.[164]

It could be said that it is regrettable that the Insurance Law which is more than two centuries younger than the LAA 1774 (UK) repeats the same omission of the 1774 Act in not including a penalty for persons (both proposer and insurer) entering into contracts of insurance on people's lives or other events without insurable interest. In this situation, it is suggested to follow the English solution, *i.e.* where a policy is effected without insurable interest, the premium should be recoverable, unless the proposer knows the law about the insurable interest but fraudulently misrepresents the relationship with the life insured on whom he has no interest.[165] If an insurer or his employee or his agent induce a person who has no insurable interest in the life insured to conclude a policy, a legal punishment should be imposed on them[166] and the proposer should be compensated by the insurer if the insured event occurs. The reasons for this suggestion are as follows:

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[163] See R, Merkin, The Insurance Contract Law, (loose-leaf), p. A.4.2-14. Three reasons are given: First, modern authorities on the *in pari delicto* principle are inclined to be rather more generous to totally innocent parties particularly when misled by negligence. Second, as far as agents are concerned, Financial Service Act 1986, s. 133 makes it a criminal offence for any person knowingly or recklessly to make a false statement, or knowingly to fail to disclose materiel facts, in order to induce another person to enter into a contract of insurance. The danger of prosecution in such cases will doubtless encourage insurers to train agents to be rather more careful in their sales talk. Third, there is undoubtedly a higher degree of competence and professional training of insurance agents today than at the turn of this century; certainly the courts are far less likely to be impressed with the argument that the agent was untrained and therefore acted innocently in representing that insurable interest was either present or unnecessary. For the application of the principle of *in pari delicto*, see also, Birds, Modern Insurance Law, (4th ed.), p. 161. 1997.

[164] IOB Annual Report for 1989, at para. 2.33.

[165] For the fraudulent conduct or wilful misrepresentation of the proposer or the insured or the beneficiary, the Insurance Law, art. 131 imposes legal liabilities on them. It is suggested that this article should also apply to the situation where the proposer has no insurable interest on the subject-matter of insurance but says that he has.

[166] See arts. 132 and 133 of the Insurance Law, where the law impose a legal punishment for an insurer or his employee or his agent who made fraud, non-disclosure or misrepresentation to their insurance consumers to induce a proposer to conclude insurance contract. It is submitted that this rule should apply to the case where an insurer, his employee or his agent induces a person who has no insurable interest in the life of the life insured.

(a) Due to the short history of the Chinese insurance industry, an ordinary person should not be treated to have as much insurance knowledge as that which the professional insurers or their agents should possess; so if an insurer or his agent, fraudulently or negligently, persuade a person who has no insurable interest on the life insured to enter into a contract, the person is entitled to recover the premium. The insurer or his agent should be punished by law if he acts deliberately.

(b) Due too to the fact that, in recent years, the number of insurance companies in China has increased rapidly, some untrained insurance staff or agents, especially some life insurance sales persons, are employed by insurance companies to sell life insurance, but, as they themselves do not even know who has an insurable interest on whose life, it is not impossible for such insurance sales persons to recklessly persuade an innocent person to effect a policy in which he has no interest at all on the life insured. If the rule of *in pari delicto* is applied to this situation, it is not fair to the innocent insurance customers. So it is suggested that the law should impose a penalty on such a "negligent" insurer or their agent to stop this situation. Otherwise arguments will rise upon the occurrence of the insured events.

3.9 Other matters in relation to insurable interest in life insurance

(1) The limitation of the amount insured in life policies

The Insurance Law is silent in respect of the limitation on the amount of insurance and no discussion or comments have been found for this question. In practice, the insurance companies issue life insurance policies without limiting of the sum insured as long as it is agreed by the life insured in writing for a death policy.[167] Up to date, a number of life policies with high sum of insurance have been effected by Chinese life insurance companies. For example, the China Life Insurance Co. Yan An branch issued a life policy with the sum insured of RMB 1,000,000,[168] and Fu Jian branch issued a life policy with the same sum of insurance.[169] It could not be said that such big insurance money could not induce murder to the life insured even if insurable

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[167] Art. 55 of the Insurance Law.
[168] See Zhang Wenzhong, China Insurance, No. 2, p. 46, 1999.
[169] *Ibid.*

interest is strictly required in life insurance, for this sum of money amounts to a 100 times an ordinary worker's annual salary in China.

In England, section 3 of the LAA 1774 expressly stipulates that the amount recoverable is only the actual loss likely to be incurred which should be valued when the policy is effected. Despite the title of the Act, this section is considered not applying to the cases where a person effects a policy on his own life[170] and on the life of his spouse.[171] Insurance by a minor child on the life of a parent is regarded as an exception of this section if the parent is legally obliged to support the child.[172] All other cases of life insurance must be supported by proving an economic or pecuniary interest at the time the policy is effected and the amount insured is limited to the interest. For instance, a parent could insure his child for only funeral expenses,[173] and a creditor has a limited interest in the life of his debtor for the debt (the insured amount may be increased to include the future interest and the costs of maintaining the insurance up to the date of the debtor's death).[174]

Contrarily, in Australia, where a person is presumed to have an insurable interest in the life of another person under section 19 of the ICA 1984, the amount of that interest is unlimited.[175] This approach, in my opinion, is not very sensible so far as protecting the life insured or preventing gambling are concerned, although it is better than the view of abolishing the requirement of the insurable interest totally in life insurance. It is not impossible, for instance, that if an employer insures his employee for a huge amount of insurance, when he is at the risk of bankruptcy, the big insurance money may become a temptation to murder.[176]

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[170] *Wainwright v. Bland* (1835) 1 Moo. & R. 481.

[171] In *Reed v. Royal Exchange Assurance Co.* (1795) Peake Add Cas 70, it was held that a wife has an unlimited insurable interest in her husband's life; in *Griffiths v. Fleming*, [1909] 1 K.B. 805, it was proposed by Vaughan Williams L.J. that a husband has an unlimited insurable interest in his wife's life. In both cases the presumption is conclusive. The common law is supplemented by MWPA 1882, s.11.

[172] See J. Birds, Modern Insurance Law, (4th ed.), p.42, 1997.

[173] There used to be an obligation to bury one's children, this may now in fact be obsolete, as local authorities are now obliged to bury any person who dies in their area. See MacGillivray on Insurance Law, (9th ed.), para. 1-92 for the details.

[174] *Anderson v. Edie* (1795) 2 Park 14; *Amick v. Butler*, 12 N.E. 518 (Ind,. 1887). See also MacGillivray on Insurance Law, (9th ed.), para. 1-83.

[175] See s. 19(5) of the ICA 1984 (Australia).

[176] An Australian commentator, A.A. Tarr said: "Making the insurable interest unlimited seems to involve some resiling from this purpose,* leaving the control to the good sense of the life insurance industry in refusing unrealistic covers even if the premium may be attractive to the insurer." * The purpose refers to the retention of the concept of insurable interest in the ICA 1984. See A.A. Tarr,

Based on the above analysis, it is submitted that a limitation on the insured amount in life insurance should be required.[177] However, owing to the fact that a person's life can not be measured by money, it is impossible for a law to give a clear-cut limitation for the maximum of the insured amount for a life policy. What is the maximum limitation is another question. It could be suggested to determine a proportion, for instance, 20 times of the annual salary for a plain worker whose annual salary is around RMB 20,000, or fix a maximum amount, *e.g.* RMB 1,000,000, for a businessman whose annual income is over RMB 200,000. This work should be done by the China Insurance Regulation Commission to provide for different standards according to particular situation.

(2) A policy on the life of a person without capacity for civil acts is not allowed

The first paragraph of article 54 in the Insurance Law stipulates that "A proposer may neither propose nor may an insurer underwrite personal insurance on a person who has no capacity for civil acts where the death of such a person is set as the condition for payment of the sum insured." This provision marks a big progress in the legislation of insurance law contrasting to other countries' insurance law relating to insurable interest. Neither English law nor Australian law has such a stipulation. It is clear from this article that any relationship, even husband and wife or parent and child, may not give support for one person to insure another who has no civil act capacity. This provision absolutely precludes the chance for some malefactors to benefit from insurance money by killing a person who has no capacity for civil acts. However, as discussed above, a parent who effects a policy on his minor child is outside the restriction of the first paragraph.[178] The reasons were analysed earlier and so do not need to be repeated here.[179]

Insurable Interest [1986] A.L.J. p. 613. However, it is very doubtful whether or not an insurer may resist the attraction of a premium without the restriction of law.

[177] It has been noted that in Singapore's Insurance Act (Cap 142, rev Ed 1994) the limitation of the sum insured is required. In s. 59(1) it is stated: "... and the policy moneys paid under such a policy shall not exceed the amount of that insurable interest at that time."

[178] See para. 2 of art. 54 of the Insurance Law.

[179] See s. 3.1(3) of this Chapter "Insurable interest in the lives of one's children", *supra*.

3.10 Conclusion and suggestions

Based on the above analysis for Chinese insurance law relating to insurable interest in life insurance, and by comparing it with England and Australian insurance law in this area, it can be concluded that, first of all, it should be confirmed that the Insurance Law made a big progress by giving some reasonable provisions relating to insurable interest in life insurance. For instance, in order to protect the safety of life insureds, the law strictly requires insurable interest for a life policy[180] and at the same time the consent of the life insured's must be shown for a death policy.[181] Moreover, the prohibition of a policy on the life of a person who has no civil act capacity reflects a social concern with the temptation of a proposer to murder such a person.[182]

However, Chinese law in the area of insurable interest in life insurance need to be amended in many aspects. (1) As has been analysed above, there is a self-contradiction between articles 11, 52 and 55 of the Insurance Law. To solve this contradiction, it is suggested that the second paragraph of article 52 (under which a person is presumed to have an insurable interest on the life insured by only showing that he has obtained the consent of the life insured regardless whether or not there is an interest between them) be removed.

(2) In China, most arguments and problems raised in practice in relation to insurable interest in life insurance are about the matters of 'legal beneficiary' mentioned in article 63 of the Insurance Law. No English or Australian laws or judicial authorities on these matters can be followed. Under this circumstance, it could be suggested that this article shall be retained by attaching a condition to it. This supplementary condition is that "the life insured's legal estate successors should be determined at the time when the life insured dies."

(3) If the second paragraph of article 52 were deleted, the list in the first paragraph could be expanded by referring to section 19 of the Australian ICA 1984. Article 52 of the Chinese Insurance Law and section 19 of the Australian ICA 1984 are similar in

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[180] Arts. 11and 52 of the Insurance Law.
[181] *Ibid.* Art. 55.
[182] *Ibid.* Art. 54.

form, but they are different in content. There are two differences between the Chinese approach and the Australian approach in respect of the categories of insurable interest in lives. First, in article 52(3) of the Insurance Law, it provides that a person has an insurable interest in the life of the other members of his family (as opposed to the persons mentioned in (1) and (2) of article 52) and close relatives if he is maintained and supported by them.[183] While in contrast the Australian ICA 1984 section 19(3) states "a person who is likely to suffer a pecuniary or economic loss as a result of the death of some other person has an insurable interest in the life of that other person and section 19(4)(c) provides that "a person has an insurable interest in the life of a person on whom he depends, either wholly or partly, for maintenance and support." It is clear that the Australian approach is that a person may insures 'anybody' on whose death the person is likely to suffer an economic loss or on whom the person depends, while the Chinese approach confines insurable interest only to the 'family membership or relatives' who provide support and maintenance for the proposer. It is submitted that the Australian approach is better, because if a person is supported for education or cost of living by another person, no matter whether they are relative or not, he will suffer financial loss when the other person dies. For example, in China, in recent years, some nice and generous people voluntarily support some poor children for their education, they do not know each other, and have never even met each other. They are not relatives or family members, but it is clear that if the supporter should die, the children who are financially assisted by the supporter may be forced to stop their education due to the inability to afford education expenses. It could be submitted that this special supporting relationship is sufficient to establish an insurable interest for the children to effect policies in the lives of their supporters. So it is suggested that the Chinese approach should widen the 'member and relative relationship' to 'any person' who provides financial support for the proposer but the consent of the life insured must be required to satisfy article 55.

Secondly, article 52 of the Insurance Law does not deal with the matters of insurable interest for relationship other than the family relationship, *e.g.* an employer on his

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[183] It is noteworthy, this sentence is slightly altered in wording and meaning by this author. The original wording by translation from Chinese to English should be "members of his family or close relatives other than those in the preceding paragraph who have a relationship of fostering or raising or supporting with him. It is ambiguous who supports whom. In order to compare conveniently with s.19 (4) (c) of

employee or a creditor on his debtor and so on, although it has been suggested by some commentators that these relationships fall into the categories of the second paragraph of article 52.[184] English common law and the Australian ICA 1984, section 19(3) and s.19 (4)(a) and (b) deal with these relationships. So it is suggested that an item in article 52 of the Insurance Law should be added: "A person who is likely to suffer a pecuniary or economic loss as a result of the death of some other persons has an insurable interest in the life of that other person."[185]

English common law categories of insurable interest in lives are too narrow to meet the needs of insurance consumers. Except for the relationship of spouses, other family relationships are not presumed to have an insurable interest in each other. A parent has no insurable interest on his child even if the parent is factually but not legally supported by the child,[186] and a child is not allowed to effect a policy on his parent in the absence of a legal obligation on the parent to support his child.[187] As the Australian ICA 1984 remains the requirement of insurable interest in life insurance[188] and expands[189] the categories established by English common law, it is submitted that the Australian approach in this context is better in view of meeting the legitimate expectations and demands of the insurance consumers. However, Australian 'unlimited interest' view[190] is not very convincing. Rather, the English view which limits the amount recovered where a person has interest in the life insured except in cases where the person insures his own life and the life of his spouse[191] is more reasonable.

Australian ICA 1984, this author alters the original wording and meaning. This altered sentence hopefully reflects the legislators' intention.

[184] Some writers give the view that para. 2 of article 52 refers to the relationships with economic interests, such as the employer and his employee or a creditor and his debtor, see note 142 *supra* for the details. I understand that this paragraph, in its wording, broadly means "any person" but does not refer to special relationships like what the writers suggested.

[185] It is referred to s.19(3) of the ICA 1984 (Australia).

[186] *Halford v. Kymer* (1830) 10 B. & C. 724.

[187] *Shilling v. Accidental Death Insurance Co.* (1857) H. & N.; *Harse v. Pearl Assurance* [1904] 1 K.B. 558.

[188] S. 18 of the ICA 1984 (Australia).

[189] *Ibid,* s. 19.

[190] *Ibid*, s 19 (5).

[191] See s. 3 of the LAA 1774 (UK) coupled with the common law.

4. The Requirement of Insurable Interest in Property Insurance

Similar to life insurance, the main purpose of the requirement of insurable interest in property insurance is to prevent gaming or wagering and to prevent the temptation of damaging or destroying the subject matter of insurance. In China, insurable interest in property insurance is governed by article 3 of the Regulations of the PRC on Contracts of Property Insurance 1983 and article 11 of the Insurance Law 1995. However, the Insurance Law does not give detailed provisions about the requirement of insurable interest in property insurance. Article 11, in its general meaning, covers all insurance contracts (life, property and liability insurances, and even marine insurance) in respect of insurable interest. Insurable interest in property insurance is complex, and article 11 is too brief to meet the needs in practice for insurance industry or for judicial purposes. It is, therefore, intended in this section to attempt to make recommendations for some detailed provisions relating to insurable interest in property insurance in the Insurance Law by introducing from or referring to the English or Australian approaches.

In England, insurable interest for goods is governed by section 18 of the Gaming Act 1845 (applies to all insurances) and the principle of indemnity.[192] Whether or not the LAA 1774 applies to real property is controversial.[193] These Acts are complemented by English common law. However, it seems that, in some aspects, English common law is so strict that reforms to the law have been suggested. The Australian ICA 1984 altered the strict common law with regard to the nature of the insurable interest required in contracts of general insurance by introducing a broad "economic or pecuniary test" of insurable interest in place of the common law's "strict proprietary test". Which approach is better is another question to be discussed in this section.

4.1 The situation in China

Article 3 of the Regulation of the PRC on Contracts of Property Insurance stipulates: "A proposer for the cover of property insurance shall be the owner or the operating manager of the insured property or a person who has an insurable interest in the

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[192] LLA 1774 does not apply to ships, goods, etc. See s.4 of the LLA 1774.
[193] See John Birds, Modern Insurance Law (4th ed.), pp. 48 – 52, 1997.

subject matter insured." According to this article, an owner or an operating manager of the property definitely has an insurable interest in his property. It seems that this article also mentions other persons who should be presumed to possess an insurable interest in the subject matter of the insurance, but it does not define who those other persons are. This answer might be inferred from article 32 of the Insurance Law which reads: "Property insurance contracts shall be insurance contracts in which property and its related interest shall be the subject matter of insurance." It could be submitted that persons who have a particular relationship with a property or the interest derived from the property are deemed to have an insurable interest in the property.

The Insurance Law defines insurable interest briefly in article 11:

"A proposer shall have an insurable interest in the insured subject matter.

An insurance contract shall be void where the proposer has no insurable interest in the insured subject matter.

The term 'insurable interest' shall refer to a legally recognised interest of the proposer in the subject matter of insurance."

Article 11 does not change the basic meaning of insurable interest and the categories in property insurance described in article 3 of the Regulations 1983. By virtue of these provisions, a person who has a legally recognised interest in the subject matter of insurance is presumed to have an insurable interest in it. Accordingly, the owner or the operating manager of the property has an insurable interest in such property, and others who have legally recognised interest in the property, such as a mortgagee, a bailee, or a carrier, are also deemed to fall into the purview. It is appropriate to discuss each of these situations separately here.

(1) Ownership of the property

According to the Civil Law 1986 (PRC), "property ownership" means the owner's rights to lawfully possess, utilise, profit from and dispose of his property.[194] An owner has a legal or equitable right to his property, and so has an insurable interest in the property he lawfully owns. It seems that there is no doubt and no contrary opinion to

[194] See art. 71 of the Civil Law 1986 (PRC).

this view. The problem is that several different types of ownership appear in China following the economic reform, which causes some difficulties in determining the extent of the insurable interest in some special cases. Up to date, China's economic system is a diversified market economy and is characterised by a co-existence of multi-economic structures, dominated by the public ownership system. In China, for the time being, property ownership can be categorised into three different types:[195] (1) State property ownership; (2) Collective property ownership; and (3) private property ownership.

Among the three types of ownership, it is undoubtedly true that no individual person may insure state property or collective property in his own name, for no one has a legal right to state or collective property, and he therefore has no insurable interest in such property.[196] Arguments may arise on insurable interest in private ownership. Private ownership can be divided, by law, into three types. These are: the ownership of private enterprises, the ownership of individual businesses and the ownership of citizen's individual personal property. The question is whether a person who owns a private enterprise or individual business has an insurable interest in the property of his enterprise or his business.

By the Regulation on Private Enterprise of the PRC, a private enterprise refers to an economic organisation, which has property owned by private individuals. Its employees must be more than eight and its purpose is to gain profit. The owner of the enterprise can have by law the means of production, such as building, machinery,

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[195] Since the economic reform in 1978, China's economic system has been changing from a planned economy to a market economy. The Socialist public ownership has correspondingly been changed to a co-existence of multi-economic structures which is dominated by the public ownership system. See, the Constitution 1982, amended in 1988, 1993 and 1999, arts. 6-11.

[196] Unlike in England where individuals may have land, railways, banks, airways or mines etc., and thus an individual has a right to insure such properties; in China, these properties all belong to the state, and are owned by the whole people, so no organisation or individual is allowed to own these properties and therefore no organization or individual has a right to insure such properties on the basis of property ownership. See, the Constitution arts. 9 and 10; see also the Civil Law 1986, art. 73. Only state-owned enterprises and units which are empowered by law to possess, operate, or manage the state property have an insurable interest in such property. Property of collective organisations of the working masses is owned collectively by the working masses. See the Civil Law 1986, art. 74(1)-(5). This means that collective organisations have lawful rights to possess, utilise, profit from and dispose of collective property. Following the economic reform, many different forms of collective organisation have appeared in rural and urban areas in China, such as agricultural co-operative organisations, rural selling co-operative societies, rural credit societies as well as urban collective enterprises. These organisations have an insurable interest in the collectively owned property. However, no individual is allowed in his own name to insure collective property.

equipment, premises, land, means of transport, trees, livestock, fruitgarden and fishpool, etc. The owner has a legal right to the assets or personal property of the enterprise and he therefore has an insurable interest in the properties. However, if the private enterprise is registered as a limited liability company, it becomes a legal person, and the ownership of the company's property belongs to the company rather than the person who established it.[197] The owner of the company therefore may not insure in his own name the company's property should the strict legally recognised interest test be taken according to article 11 of the Insurance Law.[198]

However, the individual business was defined by law differently from the private enterprise. Individual business refers to business run by individual citizens who have been lawfully registered and approved to engage in industrial or commercial operation within the sphere permitted by law.[199] It is on a smaller scale than a private enterprise. The ownership of the property which is used for the business belongs to the owner of the business, he therefore has an insurable interest in everything used in the business and can insure such property in his own name.

If the nature of insurable interest had been founded on an economic interest, an owner of a company would have been presumed to have an insurable interest in the company's property, for he would get benefit from its existence and suffer economic loss from its damage or destruction. Unfortunately, such an owner is not allowed to insure his company's property because a strict legally recognised interest test has been adopted in the Insurance Law.[200] The question of whether a pecuniary or economic loss would be sufficient to constitute an insurable interest or whether a legal or equitable interest must be shown has occasioned strong arguments since the origin of the requirement of insurable interest.[201] This question merits a detailed discussion and we will come back to it again shortly.

(2) Co-ownership and common ownership

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[197] As to the qualifications of the establishment of a legal person, see Chapter 2, arts. 19-36 of the Company Law 1993 (PRC) which was adopted at the 5th Session of the 8th NPC on 29 December 1993, and effective as of 1 July 1994, and was amended in Dec. 1999; See also the Civil Law 1986, art. 41.
[198] It is also the decision of English common law. See *Macaura v. Northern Assurance Co Ltd.* [1925] A.C. 619.
[199] See arts. 26 and 29 of the Civil Law 1986 (PRC).
[200] Art.11 of the Insurance Law.

(a) Co-ownership

Whether or not a person who is the co-owner by shares has an insurable interest in the co-owned property is not an easy question.[202] If the co-ownership is an individual partnership, *i.e.* the property is co-owned by two or more persons with shares for the purpose of business,[203] each of them has an insurable interest for his proportion of the co-owned property, for each has proprietary right for his share of the co-owned property.[204] Whether or not a co-owner has an insurable interest for the whole value of the co-owned property is not clear. If the legal or equitable interest test is strictly adhered to, it is difficult to have a positive answer. However, as a matter of fact, if the co-owned property were damaged or destroyed completely, their whole business would be impacted seriously, and each share-holder would suffer a loss more than his own shares. In this sense, each has an insurable interest for the full value of their co-owned properties. On the other hand, if each share-holder insures for only his own shares, each of them needs to make an insurance contract with the insurers, which is so inconvenient for commercial purposes. In this sense too, a share-holder should be assumed to have an insurable interest in the whole value of the co-owned property. Once the loss occurs, he can claim the whole amount from the insurer, keep the moneys equivalent with his own loss and hold the rest as a trustee for the other share-holders.[205]

However, if the co-ownership is embodied by a registered limited company by share, the shareholder has no right to insure the company's property in his own name even merely for his own shares. Because, as was mentioned earlier, as a matter of law, once the company is established, the property no longer belongs to the share-holders but to

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[201] See the English leading case *Lucena v. Craufur*d (1806) 3 B. & P.N.R. 269.

[202] Art. 78 of the Civil Law provides "Property may be owned jointly by two or more citizens or legal persons. There shall be two kinds of joint ownership, namely co-ownership by shares and common ownership. Each of the co-owners by shares shall enjoy the rights and assume the obligations respecting the joint property in proportion to his share. Each of the common owners shall enjoy the right and assume the obligations respecting the joint property."

[203] According to art. 30 of the Civil Law, "Individual partnership refers to two or more citizens associated in a business and working together, with each providing funds, material objects, techniques and so on according to an agreement."

[204] Art. 11 of the Insurance Law requires a person to have a legally recognised interest in the subject matter of insurance.

the company, the share-holders therefore lose their proprietary right to the company's property and therefore lose insurable interest in the property.

(b) Common ownership

Common ownership refers to two or more persons jointly enjoying a proprietary right for the same object on the basis of common relationship. Common ownership must be established by law or based on relative contract. For example, the relations of wife and husband; members of a family; the property inherited in common by two or more inheritors; and partnerships, etc. Each of the joint owners shall enjoy the rights and assume liabilities respecting the joint property.[206] Accordingly, each of them has an insurable interest in the jointly owned property.

(3) Management or operation rights on the property

That an operating manager of the insured property has an insurable interest is affirmed by article 3 of the Regulations on Contracts of Property Insurance 1983. A managing and operating right on property is a new form of right based on the possession of property. This right is produced under a contract. According to the Chinese Civil Law, a person or persons (citizens or collectives) contractually have the rights of possession of, utilization and profit from the particular property (owned by the state or collectives) under the contract concluded with the state or collectives,[207] but they may not dispose of this property.[208] Whether or not the persons have an insurable interest in this property depends on the agreement of the parties of the contract. The rights and obligations of the two contracting parties shall be stipulated in the contract in accordance with the law.[209] Where the contract stipulates that the operating manager shall assume liability if the contracted property is damaged or destroyed, then he has an insurable interest in the contracted property, for he will obviously suffer financial loss if the property is damaged or destroyed. Chinese enterprise's property insurance

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[205] This question will be discussed in detail in ss. 5.5 and 5.6 of this Chapter under the topics of "Insurance effected by the proposer on behalf of others" and "Co-insurance".
[206] See the Civil Law 1986, art. 78.
[207] *Ibid.* arts. 80-81.
[208] *Ibid.* art. 80.
[209] *Ibid.* art.81.

clauses also stipulate that the property under management or operation by the insured is included in the scope of such insurance.[210]

(4) Other legal or equitable relationships with the property

Persons who have a legal or equitable right over the property include not only the owners and the operating managers of the property but also those who have another identifiable legal or equitable relationship with the property.

A mortgagee, for instance, has an insurable interest for the mortgaged property before the mortgage terminates. A mortgage is usually created by a mortgagor (a debtor) based on a debt. A creditor (the mortgagee) has the right to demand his debtor to fulfil his obligations as specified by the contract or according to legal provisions.[211] In order to secure the performance of his obligation, the debtor or a third party may offer a specific property as a security.[212] A mortgage, which is created by the mortgagor (the debtor), refers to a conveyance, assignment, or demise of real or personal property as security for the repayment of money borrowed. A mortgage is usually a real property, such as a house or a piece of land, and the possession of the property is not transferred from the mortgagor to the mortgagee during the term of mortgage. The mortgagee (the creditor), for whose benefit the mortgage is created, has the right to dispose of such property if the debtor defaults, and has priority in satisfying his claim out of the proceeds from the auction of the mortgaged property.[213] Thus, if such property has been damaged or destroyed before the debtor repays the debt, the creditor (the mortgagee) would lose the right to dispose of it, and would suffer a financial loss where the debtor fails to perform his obligation. So the mortgagee (the creditor) has an insurable interest in the mortgaged property, but the sum insured is limited to within the amount of the debt simply because his legal right is restricted to within that amount.

A security may also be personal property. The possession of the property under this type of security is usually transferred from the debtor to the creditor. The transfer of

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[210] See Enterprise Property Insurance Clauses of the PICC, s. 1(2).
[211] See the Civil Law, art. 84.
[212] *Ibid.* art. 89(2).

the possession of the property to secure the repayment of the debt is called pledge which is offered by the pledgor (the debtor) or a third party to the pledgee (creditor).[214] The pledgee possesses and controls the pledge until the debtor pays off the debt to him. Under this type of security, the plegee has two-fold (or double) interests which may constitute an insurable interest in the property. On one hand, during the term of the pledge, he bears the responsibility of keeping the property safe. He is liable to return it back to the pledgor in sound condition if the debtor repays his debt in due time. On the other hand, if the debtor defaults, the pledgee shall be entitled to keep the pledge to offset the debt or have priority in satisfying his claim out of the proceeds from the sale of the pledge pursuant to relevant legal provision.[215] Thus once the pledge is destroyed, the pledgee will suffer an economic loss. He therefore has an insurable interest to the full value of the pledge.

The position of a lienee, a bailee or a carrier is much the same as in the case of a plegee. The insurable interest of a bailee in the goods of which he is custodian consists of, first, any liability of his to the bailor in the event of the goods coming to harm and, second, his own contractual entitlement to earned profits or commission for the performance of his services. In general, possession of the property with a degree of legal responsibility over it provides a basis for the existence of insurable interest in such property.

(5) Expected interest stemming from a present interest

Insurable interest is not necessarily confined to a present interest but is also extended to an expectancy based upon a present interest. Article 11 of the Insurance Law stipulates that the subject matter of insurance shall refer to property and *its related interests*[216] or the life or physical body of a person, as an object of insurance. It is also stipulated in article 32 that property insurance contracts shall be insurance contracts in which property *and its related interests*[217] shall be the subject matter of insurance. In these two articles the *related interest* is mentioned which refers to the expected interest

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[213] Art. 46 of the Urban Real Estate Administration Law 1994 (PRC); and art. 89(2) of the Civil Law.
[214] See art. 89(2) of the Civil Law.
[215] *Ibid.*
[216] My own emphasis.
[217] *Ibid*

which stems from the existing interest in the property. In other words, a person has an insurable interest in an interest which does not exist when the insurance contract is effected, but where there is an expectancy of acquiring such an interest upon a factual or existing interest. This expected interest usually means a profit. For example, a manufacturer who owns a building or a machine has an insurable interest in the production profit, because if his building or machinery is damaged or destroyed, he may suffer not only from the destruction of the property itself, but also from the loss of the profit income as expected. So he has an insurable interest not only on the property, but also in the expected profit. The latter interest, however, has to be insured quite separately; the usual indemnity policy on property will not indemnify against consequential losses.

Similarly, a user of the property can insure not only the property he possesses but also the profit income. A manager has the right to insure his managing income, a contractor of a project has an insurable interest for his contracting income, a landlord may insure his rent interest, a carrier can insure his freight and a bailee has an insurable interest in his commission for taking care of bailment property.[218]

In summary, the key point of the Chinese Insurance Law relating to insurable interest in property is that insurable interest is an interest recognised by law. It is submitted that a strict inherence to this requirement may cause inconvenience in practice and unjust results which will be discussed later.

4.2 English Law relating to insurable interest in property insurance

In England, insurable interest in goods and insurable interest in real property can be discussed separately because they are regulated by different laws.

(1) Insurable interest in real property

In England, as far as the insurable interest in real property is concerned, the strong and basic argument is whether or not the LAA 1774 is applicable to insurance contracts of

[218] As to the detailed information, see Zhou Yongsheng, Baoxian Yu Falu (Insurance and Law), (2nd ed.) pp. 108-120. Shangdong People's Press, 1998.

real property. In common law, some authorities decided that the LAA 1774 applies to the insurances of real property. In *Re King*,[219] the Court of Appeal held, *obiter*, that the LAA 1774 did apply to policies of building. Also some commentators analyse that the words 'other event or events' refer to events affecting real property.[220] However, contrary decisions in common law were found in recent cases. In *Mark Rowlands Ltd v. Berni Inns Ltd* [221] the Court of Appeal made a decision which overturned its own dictum in the earlier case of *Re King*. *Mark Rowlands* concerned a policy, taken out on a building, in the name of the landlord, in which the premiums had in reality been paid by the tenant, as an element of the rent. A fire occurred and the insurer of the landlord was arguing that the landlord's unnamed tenant could not benefit from the insurance because the tenant was not named in the policy as required by section 2 of the LAA 1774. Kerr L.J. stated that "this ancient statute was not intended to apply, and does not apply to indemnity insurances, but only to insurances which provide for the payment of a specified sum upon the happening of an insured event."[222] This decision was followed by the Privy Council in case of *Siu Yin Kwan v. Eastern Insurance Co. Ltd.*[223] Some commentators took the same view that the LAA 1774 does not apply to realty.[224]

The significance of the issue of whether or not the LAA 1774 applies to real property insurance is given by Professor Merkin as follows.[225]

(a) If LAA 1774 does apply, the insured must demonstrate insurable interest at the inception of the policy in accordance with LAA 1774, section 1, as well as

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[219] [1963] Chap. 459, at 485 *per* Lord Denning M.R.

[220] See J. Birds, Modern Insurance law, (4th ed.) p. 50, 1997. He comments: "... it seems unlikely that there were in existence in 1774 non-indemnity, *i.e.* valued, insurances on buildings which could be caught by the Act. Given that section 4 expressly exempted marine and goods policies and that it is unlikely that in 1774 forms of insurance other than life, marine, goods and buildings insurance existed, the words "other event or events" must surely literally incorporate ordinary insurances of real property." See also R. Merkin, Insurance Contract Law, p. A.4.4-02, it is commented that it is difficult to see what meaning is to be given to these words (*other event or events*) if LAA 1774 does not extend beyond life and accident policies.

[221] [1986] Q.B. 211. The ratio of this case concerns an insurer's subrogation rights and this aspect of it is discussed in Chapter Five of Subrogation, *infra.*

[222] [1986] Q.B. at 227.

[223] [1994] 2. A.C. 199.

[224] See Halbury's Laws, (4th ed.) vol.25, p.341, 1994; Ivamy, Fire and Motor Insurance (4th ed.) p.184; See also MacGilivray on Insurance Law, (9th ed.), p.67, para. 1-155, 1997. It is noted that previous editions of MacGilivray and Parkington on Insurance Law have argued that the LAA 1774 applies to policies on buildings. See the (9th ed.), p. 66, para.1-154.

[225] Professor Merkin, Insurance Contract Law, p. A.4.4-01.

showing some interest at the date of the loss in order to satisfy the common law indemnity principle. By contrast, if LAA 1774 does not apply, the insured need not demonstrate any insurable interest at the outset, although the insured must possess some expectation of acquiring such an interest in order not to be caught by the prohibition of the Gaming Act 1845, section 18.

(b) The LAA 1774, setion 3 restricts the insured's recovery to the amount of his interest. Consequently, if LAA 1774 governs policies on land and buildings it follows that it is impossible for the insured to insure both his own full interest and the interest of any other person, as any recovery by the insured under the policy will be limited to an amount representing his own interest. It should be added, however, that if the insured does recover to the extent of his own interest, he may be required by contract or statute to hold the proceeds of the policy on trust for some other person. If, by contrast, LAA 1774 is not applicable, the ceiling on recovery imposed by LAA 1774, section 3, is immaterial and the insured may recover an amount in excess of his own interest; this would permit the insured to insure a number of interests under a single policy, as is the case with policies on goods.

(c) The LAA 1774, section 2 requires the insertion into the policy of the names of all the person interested in the insurance. There is no equivalent provision governing policies falling outside LAA 1774 which is capable of applying to land and buildings.

(2) Insurable interest in goods

Goods policies are expressly excepted from the regulation of the LAA 1774.[226] In England, there is no statute which requires that a policy on goods is to be supported by insurable interest in insured, other than on goods involved in a marine adventure which are governed by MIA 1906. However it is not saying that goods policies can be made freely without being governed by any statute or common law. Policies in goods are governed by section 18 of the Gaming Act 1845 and the common law principle of indemnity. Section 18 of the Gaming Act 1845 provides: "All contracts of agreements, whether by parole or in writing, by way of gaming or wagering, shall be

[226] See s. 4 of the LAA 1774.

null and void; and no suit shall be brought or maintained in any court or law or equity for recovering any sum or money or valuable thing alleged to be won upon any wager…." It is held that insurance contracts are included in the contracts which the Gaming Act was enacted to prevent. The principle of indemnity means that an insured may not recover more than he has lost. Consequently, the position at the inception of the insurance is governed by the Gaming Act 1845, section 18, where the proposer who has no interest in the property at all or has no expectation of obtaining an interest cannot take out an insurance policy. While the position following a loss is governed by the indemnity principle, the proposer may recover only by showing that he suffered a loss and the amount recovered is no more than his factual loss.

(3) Persons who are presumed to have an insurable interest in property insurance

Insurable interest in property is not confined to absolute legal ownership. As was examined above, two requirements for insurable interest in English law may be identified. First, the insured must be so situated that he will suffer economic loss as the proximate result of damage to or destruction of the property. This was considered by Lawrence J. in *Lucena v. Craufurd* [227] to be sufficient criterion of insurable interest. Another one was Lord Eldon's dictum which described the requirement as possession of a legal or equitable right in a property. As the latter view represents the English law, therefore, a mere expectation or even a moral certainty of loss should particular property be destroyed is not enough. There must be a present right to a legal or equitable interest or a right under contract.[228] Consequently, a shareholder has no insurable interest in the company's property[229] and a possessor of property in which there is no right of enjoyment and in respect of which no liability is owned would not suffice to constitute an insurable interest in the property possessed.[230]

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[227] (1806) 2 Bos. & P.N.R. 269.
[228] See *Lucena v. Craufurd* (1806) 3 B. & P.N.R. 269; See also s.5 of the MIA 1906 (UK), where there is a legal or equitable interest being required which has been held to apply also to non-marine insurance.
[229] *Macaura v. Northern Assurance Co.* [1925] A.C. 61.
[230] *Ibid.* This case will fully discussed shortly.

4.3 The approach of Australian Law

In Australia, insurable interest in general insurance[231] is now governed by section 16 and section 17 of the ICA 1984. Section 16 provides: "(1) A contract of general insurance is not void by reason only that the insured did not have, at the time when the contract was entered into, an interest in the subject matter of the contract. (2) Sub-section (1) does not apply to a contract that provides for the payment of money on the death of a person by accident or sickness but not otherwise." It should be noted that section 16 (1) relieves the insured from possessing an interest at the time when the contract was entered into. Section 16 (2) makes it quite plain that accident or sickness policies which include death cover require an insurable interest at the time when a contract is concluded, and this point is further confirmed in section 18 of the ICA 1984 which has been discussed earlier. It was held that the repeal of the requirement of an insurable interest in general insurance at the time a policy is effected would not give more opportunities of gambling or wagering, for the principle of indemnity operates and other State laws, such as gaming and lottery legislation, apply.[232]

Section 17 adopts the Australian Law Reform Commission's recommendations that the strict proprietary interest test be abandoned in favour of one based on economic loss. In other words, legislation should provide that where an insured is economically disadvantaged by damage to or destruction of the insured property, the insurer should not be relieved of liability by reason only of the insured's not having a legal or equitable interest in the property.

Section 17 is in the following terms: "Where the insured under a contract of general insurance has suffered a pecuniary or economic loss by reason that property, the subject matter of the contract, has been damaged or destroyed, the insurer is not relieved of liability under the contract by reason only that, at the time of the loss, the insured did not have an interest at law or in equity in the property." This section changes the common law by abandoning the strict proprietary interest test in favour of

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[231] The term "general insurance" is defined in s. 11(6) of the Insurance Contracts Act 1984 (Australia) to mean "a contract of insurance that is not a contract of life insurance".
[232] See A.A. Tarr, *Insurable Interest*, [1986] A.L.J. p.619.

a test of economic loss. The *Macaura*[233] case is overturned; all that is required is that the insured suffers a pecuniary or economic loss through the damage to or destruction of the thing insured. It is, of course, vital to appreciate that section 17, while it has changed the nature of the interest required to validate a contract of general insurance, has not relieved the insured from possessing an interest at the time of the loss. The main contribution of section 17 is that it establishes a more legitimate or reasonable test for insurable interest – "a test of economic loss" by repealing the strict legal or equitable interest test.

4.4 Legally recognised interest or economic interest – the test of insurable interest in property insurance

Perhaps the strongest argument in the context of insurable interest in property insurance is whether or not a proposer must have a legal or equitable interest or possesses proprietary right for the subject matter of insurance. In England, in common law, an insured must stand in some legally recognised relationship to the subject matter of insurance, in consequence of which he may benefit by its safety or be prejudiced by its loss. This is the narrow view for the concept of insurable interest which was pointed out by Lord Eldon In the classical case of *Lucena v. Craufurd.*[234] The other is the wider view of economic interest test which was proposed by Lawrence J. in *Lucena.*[235] The narrow test prevails in England, the decision of the House of Lords in the case of *Macaura v. Northeren Assurance Co. Ltd.*[236] is a typical illustration of the strict legally recognised interest. In that case, Macaura, the insured, sold lumber to a limited company in exchange for shares in that company. As the company continued to operate the insured also become a substantial creditor of the company. The timber was destroyed by fire and the insured sought to recover in respect of this loss under a fire insurance policy taken out in his name. However, it was held that he did not have an insurable interest in the company's property. In his capacity as a shareholder he had no legal or equitable interest in the property owned by the company, but merely an entitlement to share in the profits while the company

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[233] [1925] A.C. 619.
[234] *Lucena v. Craufurd* (1806) 2 B. & P.N.R. 269 has been commonly cited when discussion the nature of insurable interest. See *supra* s. 2.2 of this Chapter "The nature of insurable interest".
[235] *Ibid.*
[236] [1925] A.C. 619.

continued to carry on business and to share in the distribution of surplus assets on winding up. If Lawrence J's broader definition propounded in *Lucena* [237] had been adopted, the insured could have recovered simply because he had benefited from the existence of the company's assets and he was prejudiced by their destruction.

The English law of narrow test of insurable interest has been criticised by many commentators. For example, Professor Malcolma Clarke comments: "The insured has an insurable interest in a property, if he has an 'economic interest' in the property. That should have been enough for the law of England, as it is in other countries, to allay any anxiety about wagering or arson, but it was not. In England, the insured is also required to stand in 'a legal or equitable relation' to the property insured."[238] Many other common law jurisdictions have dispensed with the requirement of a legal or equitable interest and have adopted the 'economic test', such as Australian, Canada and the United States.[239] It has been noted that English courts are impatient at the restrictive nature of the English law, but it has been submitted that the requirement of a legal interest or obligation regarding the property cannot be dispensed with except by a reforming statute or by restatement of the law by the House of Lords.[240]

As discussed above, a welcome approach opposite to the decision of *Macaura*[241] was established in Australian ICA 1984, section 17. This section changes common law by abandoning the strict proprietary interest test in favour of a test of economic loss and providing that, when the insured suffers pecuniary or economic loss because insured property has been damaged or destroyed, the absence of an interest at law or in equity in the property at the time of loss does not relieve the insurer from liability.

In China, article 11 of the Insurance Law expressly provides that "the term 'insurable interest' shall refer to a legally recognised interest of the proposer in the subject matter of insurance." It is clear that the rigid proprietary test of insurable interest is adopted by Chinese law. The effect of this article is that an insurable interest in property insured or some interests derived from the proprietary right or possession on the

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[237] (1806) 2 B. & P.N.R. 269.
[238] See M. Clarke, Policies and Perceptions of Insurance – an Introduction to Insurance Law, p. 29, 1996.
[239] See, MacGillivry on Insurance Law (9th ed.), paras. 1-59 and 1-117, 1997
[240] *Ibid.* para 1-117.

property is enjoyed by persons such as an owner, or a mortgagee on the mortgaged property, or a bailee on the goods under his custody who has a legally recognised relationship with the property. If a person has only an economic interest with the subject matter, but this interest is not recognised and protected by law, the person is not presumed to possess an insurable interest in the property. For example, a bailee has no insurable interest in the full value of goods on bailment for he has no legally recognised interest in the goods, he only has an insurable interest in his personal liability for the goods. However, it is noted that there are several understandings for the term "legally recognised interest". Most Chinese writers consider that "legally recognised interest" is opposite to an interest which is obtained from an illegal or unlawful action such as stealing or smuggling. They comment that a person may not be assumed to have an insurable interest on the goods he has stolen or smuggled.[242] It was also argued by Mr Zhu[243] that "all economic interests are legally recognised, so the economic interest and legally recognised interest are the same thing."[244] Let us still take the *Macaura* case as example, Macaura, as a substantial shareholder and creditor, had a economic interest in the company's property, (because if the company's property was damaged or destroyed, he would suffer economic loss), but he had no relationship with the company's property in law or equity, so it was decided that he had no insurable interest on the company's property. So the argument that the economic interest and legally recognised interest are the same thing is obviously wrong.

It is submitted that the economic test is more reasonable because of the following points:

(1) Under the strict legal or equitable interest test, many proposers cannot get insurance cover for their true economic loss in cases similar to *Macaura,* such as a

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[241] [1925] A.C. 619.

[242] See Li Yuquan, Baoxianfa (The Insurance Law), p. 73, 1997; Yu Xiannian, Zuixin Baoxianfa Tiaowen Shiyi (Most current explanation for the Insurance Law), p. 56, 1995. See also Ding Yunzhou, Zhongguo Baoxianfa Jianming Jiocheng (A brief course on the Insurance Law of the PRC), p. 34, 1995. It is considered that the term 'legally recognised interest' refers to a wider meaning, for some interests are not illegal or unlawful, but they are not recognised or protected by law. The *Macaura* case is a good example for this point.

[243] Mr Zhu Xincai was then the general manager of the Hua Tai Property Insurance Company of China, Qingdao branch. I discussed with him the question of "economic interest and legally-recognised interest" when I was invited to give a lecture on insurance law in that company in July 2000.

[244] His view was supported by Chi Jiankai, the deputy manager of the Hua Tai Property Insurance Company of China, Qingdao Branch.

creditor who has, in the absence of a mortgage or lien, no insurable interest in his debtor's property, or a would-be purchaser, who has yet to acquire possession or ownership of the goods, and so cannot insure them in transit unless they are in his risk, *e.g.* a FOB buyer cannot effect a policy for his goods for pre-shipment period. This gives the insurers a chance to refuse the proposer's claim technically, and it is not commercially convenient where a proposer has no or has limited insurable interest in the subject-matter of insurance, but he insures the property to the benefit of others. This question will be discussed later.

(2) On the other hand, the purposes of the requirement of insurable interest are to prevent gaming or wagering contracts and to prevent or reduce the deliberate destruction of the insured subject-matter by the insured when he has no insurable interest in it. In this sense, the two tests of 'strict proprietary interest' and 'economic or pecuniary interest' do not make any difference as far as their effects are concerned, and the former test does not play a better role than the latter one in achieving either of the two purposes. The rationale is that the abandonment of the proprietary interest test in favour of one based on economic loss will allow more flexibility to insurers and insureds without in any way promoting gaming and wagering in the form of insurance or adding to the risk of the destruction of the property insured.[245] Further more taking the economic interest test would not increase the danger of deliberate destruction by the proposer. It is hard to say that a person will have more intention to destroy an insured property in which he has only an economic interest than one in which he has a legally-recognised interest.

(3) Because the purpose and function of insurance is to offer an economic or pecuniary protection, but not to reinstate the insured's legal rights, it is sufficient for a person to prove that he would suffer an economic or pecuniary loss.

If the above points are reasonable, why not adopt the 'economic interest' test for insurable interest in place of the 'strict proprietary test'?[246]

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[245] See, A.L.R.C., Report No. 20, p.75, para.120; See also K. Sutton, Insurance Law in Australia, p.374, 1991.

[246] Some other Chinese writers or commentators are also in favor of the 'economic test of insurable interest'. One writer said that "insurable interest, in essence, is a very close economic relationship between the insured and the subject matter of insurance". See Yao Xinchao, *Haishang Baoxian Zhongde Baoxian Liyi Yuangze (Insurable interest in marine insurance),* Insurance Studies, No.5, p. 59, 1996. See also, Hao Yansu, Caichan Baoxian (Property Insurance), p. 49, 1996.

4.5 Insurance effected by the proposer on behalf of others

In certain situations an insured has only a limited interest in a property, for instance, a bailee has an interest only in his liability for the goods under his care, and a mortgagee has an interest in the mortgaged property for only the amount of the debt the mortgagor (the debtor) owes to him. There is no doubt at all that such an interest is a legally recognised interest, a person may insure it for his own benefit, and any statutory requirement is thereby satisfied. However, the question of whether a person who has a limited interest in a particular property may insure it for its full value for his own interest and other parties interested is somewhat difficult. Complex and intricate problems have arisen concerning the extent to which a person who possesses either a limited interest in property or no interest at all may effect a valid insurance on it for the benefit of someone else, and recover an indemnity to the full value of the property in the event of a loss. This question has been dealt with in England in common law. In Australia, this was formally codified in the statute law of the ICA 1984.[247] In China, such a complex and deep question has not yet been touched on, either in the statutory Insurance Law or in the judicial realm. It is a pity to leave a loophole in the Insurance Law in this respect. However, this question might be implied in some ambiguous and contradictory articles of the Insurance Law. It is necessary to discuss the different views of the three countries separately:

(1) Confusion and contradiction in the Insurance Law

From the provisions of the Insurance Law, it is difficult to give a clear-cut answer to the question of whether a person who has a limited interest in a particular property may insure the property for its full value. Some contradictions have been found between the articles. First, article 11 is contradictory to article 21. According to article 11 of the Insurance Law, it seems impossible for a person with a limited interest or without interest at all to insure the full value of a property, because this article provides that the proposer must have an insurable interest and the interest must be a legally recognised interest. This confines the proposer to insure only for his own interest as recognised by law. However, in article 21 it defines an "insured" as a

[247] S.49 of the ICA 1984 (Australia).

person whose property or physical body is covered by an insurance contract and who has the right to claim for insurance moneys. Article 21 also stresses that the proposer may be the insured. It is clear from article 21 that the insured may be the proposer himself and may also be another person rather than the proposer. In other words article 21 means that the proposer may insure for another person's (the insured's) interest, this person being the owner of the subject matter of insurance, and the insured may claim directly against the insurer. On the other hand, if the insured whose property is covered by the policy is a third party rather than the proposer, it means that a proposer who has no interest in the property may insure it for another person's interest. However, article 11 stresses that a proposer must have an insurable interest in the subject matter insured, or otherwise the policy is void. It is not difficult to note there is a confusion between these two articles.

Secondly, article 21 is contradictory to article 9. Paragraph 2 of article 9 provides: "the term 'proposer' shall refer to a person who concludes an insurance contract with an insurer and bears an obligation to pay a premium in accordance with an insurance contract." By reading article 9 in combination with article 21, it seems that the proposer only bears the duty to pay a premium but cannot enjoy the right of claiming for the insurance money, while the insured whose property is covered under the policy has the right to seek for the insurance money, but does not need to pay the premium. Thus if A who has an insurable interest in the subject matter of insurance (to satisfy article 11 of the Insurance Law) effects a policy for B's property, B is allowed to recover directly against the insurer, but A is not allowed to do so. It should be noted that in this case both A and B have interest in the property,[248] but only B can recover while A can not. It seems absurd that A, who is the real party to effect a policy with the insurer, pays the premium for the policy but is precluded from recovering the insurance money.

Although these articles are so confused and contradictory, it could be inferred from article 21 that in property insurance the proposer and the insured may different persons, that means a person may insure for others. If this inference is correct, another

[248] According to art. 11 of the Insurance Law, A, as a proposer, must have an insurable interest in the subject matter of insurance. B, as an insured, whose property is covered under the insurance (art. 21), definitely has an insurable interest in the subject matter.

question arises is that in what circumstances a person should be allowed to insure for another. From article 21, it can only be inferred that a person can insure for another interested and the other person can claim directly against the insurer but nothing more. As will be discussed shortly, in England and Australia a person who has a limited interest or who has no interest at all may insure for another person with interest in the subject matter of insurance, such as a bailee for his bailor[249], a mortgagee for his mortgagor.[250] Equally, an agent who has no insurable interest at all in the subject matter of insurance can insure for his undisclosed principal provided the agency relationship exist.[251] Whether or not article 21 refers to such relationships is not clear. In order to modify these provisions, it is convenient at this juncture to consider what the approaches are in English law and Australian law relating to this question.

(2) The English approach

In England, in insurance on goods, the question of whether a limited owner, or indeed someone without insurable interest at all in a particular property, may insure for the full value of the property and recover its full value upon a loss, for the another's interest and for his own interest is not difficult to answer. Insurance on goods effected by a person with a limited interest or without interest for its full value is definitely permissible. As was noted above, the LAA 1774 does not apply to insurance on goods,[252] and therefore the amount insurable is not limited by statute to the amount or value of the insured's personal interest. Further, as there is no obligation to insert in the policy the name or names of all persons for whose benefit the insurance is made, the named insured can insure not only on his own behalf but also on the behalf of others interested in the goods.

In real property this question is not straightforward for, as was noted earlier, it depends on another question, that is whether or not the LAA 1774 applies to insurance in real property. This is still open for issue. If it does, section 2 of the Act prohibits the named insured with a limited interest in the property from recovering on behalf of

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[249] *Waters v. Monarch Fire & Life Assurance Co.* [1856] 5 E. & B. 870; 119 E.R. 705; *Tomlinson (Hauliers) Ltd v. Hepburn* [1966] A.D. 451.
[250] *Tomlinson (Hauliers) Ltd v. Hepburn* [1966] A.C. 451; *Petrofina (UK) Ltd v. Magnaload Ltd* [1984] Q.B. 127.
[251] *Siu Yin Kwan v. Eastern Insurance Co.* [1994] 2 A.C. 199.

any other person interested who was not named in the policy, and it also prevents the named insured with no interest from covering the interest of an undisclosed principal. Additionally, s. 3 of the Act appears to prevent an insured with a limited interest from recovering an indemnity in excess of his interest for the benefit of another. Although, there are different views for the application of the LAA 1774 in real property, in certain circumstances a person having a limited interest could insure for and recover the full value of the subject matter insured under the English law. These circumstances will be illustrated soon.

The question of what interests were covered by a particular policy was primarily a question of fact depending on the intention of the parties when the contract was effected. If at the time the contract was made the person insuring intended to protect not only his own limited interest but also the interests of other persons in the subject matter, he might insure for and recover the total value, subject of course to any contractual or statutory provision to the contrary. The intention of the insured must be determined by the construction of the policy itself and, in the case of ambiguity, by considering surrounding circumstances. It was not necessary that evidence should be called to prove the subjective intention of the insured to cover interest other than his own.[253] In the absence of an intention to cover the interests of other persons, a person with only a limited interest in the subject matter who insured it for the full value was not entitled, if the property was destroyed by fire, to recover that value, even on the basis that he must account to the others interested for the excess over what was required to indemnify him against his own loss. A person with a limited interest who intended only to cover himself was not able to recover from the insurer anything beyond the amount of the loss caused to his own particular interest, and any mistake by him as to the nature and extent of his interest could not make that interest greater than in fact it was.[254]

Another question involved is whether a third party has the right to claim directly against the insurer. This question was not so clear until the enactment of the Contracts

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[252] S.4 of the LAA 1774 (UK).
[253] *Tomlinson v. Hepburn* [1966] A.C. 451, at 451, 470, 473-474, 480. See also MacGillivray paras. between 1-172 and 179 for the detailed analysis about the construction of the policy for the intention of the insured.
[254] *British Traders' Insurance Co. Ltd v. Monson* (1964) 111 C.L.R. 86 at 104.

(Rights of Third Parties) Act 1999 (UK).[255] Before examining the 1999 Act, it is necessary to have a brief discussion on the legal situation relating to this question prior to this Act. It was said[256] that the third party would be able to claim directly against the insurer only if he could show specific statutory authority[257] or that the insured contracted as trustee or agent for him, unless in some situations the law was willing to develop a theory of co-insurance which would say that there were separate sub-contracts between the insurer and each insured. Outside trust and agency, the third party was faced with the doctrine of privity of contract.[258]

As far as the trust is concerned, many decisions held that a person with a limited interest in particular goods could effect a policy to cover his own interest and the interest of others interested in the particular goods as a trustee, and it is irrelevant whether or not the other persons knew anything about the policy.[259] These decisions meant that the other persons were able to sue directly under the policy. However in the case of *Re E Dibbens & Sons Ltd.*,[260] it was held that the other persons could claim directly only if they had contracted with the named insured to require the insured to insure for their interests. The sum is held in trust if there is a contractual duty to insure, but not otherwise. This case involved a policy procured by a warehouseman of furniture and domestic property, describing the goods as being held 'on trust'[261]. On the warehouseman's insolvency, the question arose as to whether the insurance proceeds in excess of the warehouseman's own interest were held in a fiduciary capacity for the bailors. This was important because the warehouseman had become insolvent. Harman J held that those customers who had contracted with the warehouseman on the basis that their goods would be insured by it were owed

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[255] 1999 Chapter c. 31. This Act implements, with some amendments, the recommendations of the Law Commission in its Report on *Privity of Contract: Contracts for the Benefit of Third Parties.* Law Com No 242 (1996) (UK).

[256] See, J. Birds, Modern Insurance Law, (4th ed.), p. 64, 1997.

[257] As is the case in respect of compulsory motor insurance: s.148(7) of the Road Traffic Act 1988 (UK);

[258] "Privity of contract" means that, even if a contract is made with the purpose of conferring a benefit on someone who is not a party to it, that person (a "third party") has no right to sue for breach of contract.

[259] See *Waters v. Monarch Fire and Life Assurance Co.*, (1856) 5 E. & B. 870; and *Tomlinson (A.) (Hauliers) Ltd. v. Hepburn* [1966] A.C. 451.

[260] [1990] B.C.L.C. 677.

[261] In the earlier cases, the phrase "on trust" when used in policies was not given the meaning of trust in its full sense. See cases *Waters v. Manarch Fire and Life Assurance Co.*, (1856) 5 E.& B. 870; *North British v. London, Liverpool & Globe* (1877) 5 Ch.D. 569; and *Tomlinson (A.) (Hauliers) Ltd. v. Hepburn* [1966] A.D. 451.

fiduciary duties in relation to the insurance premiums paid by them to the warehouseman, and were thus able to make proprietary claims against the surplus policy proceeds. By contrast, those bailors who had not required insurance to be taken out had no fiduciary relationship with the warehouseman, and remained mere unsecured creditors in any claim for the proceeds of the policy. The judge stressed there was no trust in the strict sense, but the fiduciary duties meant that, for the purposes of the insolvency laws the proceeds were within the description of "trust property" and so did not form part of the general pool of assets.

As far as an agency is concerned, it has been held that an unnamed principal for whose benefit or on whose behalf the policy is effected is allowed to sue directly against the insurer. The decision of *Siu Yin Kwan v. Eastern Insurance Co. Ltd.*,[262] illustrates this. A marine policy was taken out by a firm of shipping agents in their own name. They had been instructed to insure the liability of a shipowner, but the shipowner's name did not appear in the policy and there was no indication that the shipping agents were acting as agents rather than as insureds in their own right. It was held that the shipowners were entitled to sue as undisclosed principal because a factual agency relationship existed between the insured (the shipping agent) and the unnamed principal (the shipowners), although, as it has been commented, the rejection of the broader arguments for the insurers concerning the personal nature of the insurance contract is open to challenge.[263] It seems that the view in *Siu Yin Kwan* that an undisclosed principal is permitted to claim directly against the insurer is accepted in *National Oilwell (UK) Ltd v. Davy Offshore Ltd.*,[264] which decided that a co-insured was able to make a direct claim on the insurance contract, but only to the extent its claim was covered by the policy.

From the above cases, it must be concluded that, in common law, a person with a limited interest or without any interest in a property could insure it for other persons interested. It is irrelevant whether or not he owed any duty to the other persons interested to effect the insurance, or whether or not he acted without instructions or without its being known for whom the policy was effected, or that the interests of the

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[262] [1994] 1 All E.R. 213.
[263] See J. Birds, Modern Insurance Law, (4th ed.) p.67, 1997.
[264] [1993] 2 Lloyd's Rep. 582.

others were contingent only. However, it is essential that at the time of insuring he should intend to cover their interests as well as his own. So long as his intention was clear, it was unnecessary for him to disclose it to the insurer unless there was a condition in the policy to that effect. However, the third party is not allowed to claim and seek payment directly from the insurer unless, as was considered above, he could show specific statutory authority[265] or unless the insured contracted as trustee[266] or agent[267] for him.

Now, the Contracts (Rights of Third Parties) Act 1999 (UK) has changed the situation in respect to the third party's right of enforcing a term of the contract. In s.1 of the Act 1999, it is stipulated: "(1) Subject to the provisions of this Act, a person who is not a party to a contract (a "third party") may in his own right enforce a term of the contract if

(a) the contract expressly provides that he may, or

(b) subject to subsection (2), the term purports to confer a benefit on him.

(2) Subsection (1)(b) does not apply if on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party.

(3) The third party must be expressly identified in the contract by name, as a member of a class or as answering a particular description but need not be in existence when the contract is entered into."

Section 1 gives effect to the central purpose of the Act. It sets out the circumstances in which a third party would have the right to enforce a term of the contract. Subsection (1) sets out a two-limbed test for the circumstances in which a third party may enforce a term of a contract. The first limb is where the contract itself expressly so provides. The second limb is where the term purports to confer a benefit on the third party unless it appears on a true construction of the contract the contracting parties did not intend him to have the right to enforce it (subsection (2)). Subsection (3) requires that, for subsection (1) to apply, the third party must be expressly identified in the contract by

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[265] As is the case in respect of compulsory motor insurance; s. 148(7) of the Road Traffic Act 1988 (UK).

[266] There were different decisions to the question of whether a named insured who had a limited interest in the subject matter insured could insure for other persons interested as a trustee. See *Waters v. Monarch Fire and Life Assurance Co.*, [1856] 5 E. & B. 87; and *Tomlinson (A.) (Hauliers) Ltd. v. Hepburn* [1966] A.C. 451; see also *Re E. Dibbens & Sons Ltd.*, [1990] B.C.L.C. 677.

[267] As far as agency is concerned, See *Siu Yin Kwan v. Eastern Insurance Co. Ltd.* [1984] Q.B. 127.

name, class or description, but establishes that the third party need not be in existence when the contract is made.

As far as an insurance contract where the insured effects a policy for himself and a third party is concerned, the third party may enforce the term which purports to confer a benefit on him, as long as the conditions mentioned above are satisfied. Accordingly, the third party may claim directly from the insurer. However, the British insurance industry's initial approach has been to prevent or limit the application of the Act. How the industry's cautious reaction will influence the impact of the Act remains to be seen.

It must be noted that the approach that a person who possesses a limited interest or has no interest at all in a particular property is allowed to insure the property as whole is itself a rebut to the narrow view of the 'strict proprietary interest test' of insurable interest in property. If the narrow view had been strictly adhered to, it would not have been allowed for such an insured to insure the full value of the property on which he has only a limited interest legally recognised or has no interest at all. In contrast, the 'economic or pecuniary test' may permit such an insured to do so. So it could be concluded that in England, it is not definite to say that the 'strict proprietary test' is the law.

(3) The Australian approach

In Australia, as far as the limited interest is concerned, the ICA 1984 has somewhat changed common law in many aspects. Section 49 deals with this question. The general meaning of section 49 is that where:[268]

(a) there is a contract of general insurance covering property in which the insured and some other person each have an interest;

(b) a loss occurs in respect of that property (which must be a loss covered by the insurance contract as the section refers to the insurer's liability);

(c) the contract of insurance provides cover in respect of another person's interest in that property;

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[268] The meaning of this section was summarised by Kenneth Sutton in his work of Insurance Law in Australia, (2nd ed.), p.385, 1991.

(d) the insurer's liability to the insured in respect of the particular claim, had the insured been the only person with an interest in the property, would have exceeded this actual liability to the insured in respect of the loss;

(e) within three months after the occurrence of the loss a person other than the insured, who has an interest in the property (an interest which on the indemnity principle must exist at the date of the loss and is one which is covered by the contract of insurance) gives a written notice to the insurer advising him of his interest .

then the insurer is liable, at the end of the three months, to pay to that third person the difference between his actual liability to the insured in respect of the insured's loss and what his liability would have been had the insured been the only person with an interest in the property insured, provided of course that such a third person has suffered a loss to that extent.

It is clear from this section that under the situation in which a person has a limited interest in a property insured and he insured it for its full value, when a loss occurs the insurer is liable to indemnify interested parties up to the maximum amount provided for by the policy. The intention of the insured as to whether he insured for his own interest or for both his own interest and the interest of other interested persons is irrelevant provided the insurer has promised to provide cover for the whole property.

It should be noted that there are differences in two aspects between English common law and Australian statutory law in respect of limited interest:

(a) The insured's intention to insure: In English common law, it is essential, in order that a policy on property effected by one with a limited interest in it should be held to cover the interests of other persons as well as his own, that it should have been the intention of the insured to cover their interests. The intention of the insured is derived from the construction of the policy.[269] The insured can recover the full amount of the loss only if his intention was clear, upon the construction of the policy, to cover himself as well as the other persons interested in the subject matter of the insurance. Contrarily, under section 49 of the Australian ICA 1984, it is not a question of whether the insured intended to insure his personal interest alone or whether he also intended to protect the interests of others having an interest in the

[269] *Thomlinson (A.) Hauliers) v. Hebturn* [1966] A.C. 451; [1966] 2 W.L.R. 453.

property. As long as the insured insured its full value and the insurer did not give any opposite indication in writing, before the contract was entered into, stating that the insurance cover provided by the contract would not extend to such an interest,[270] the insured is able to recover the full amount of the loss.

(b) The third party's right to claim: In English common law, before the Contracts (Rights of Third Parties) Act 1999 (UK), generally, the third party was not allowed to claim and seek payment directly from the insurer.[271] The 1999 Act gives a third party the right to enforce a term of the contract[272] provided that the third party is expressly identified in the contract by name, class or description,[273] and the power to exclude the Act in section 1(2) has not been exercised. Section 49 of the Australian ICA 1984 gives the third party a right to claim directly against the insurer by giving a written notice within three months after the loss, advising the insurer of his interest. It is not necessary, by the Australian Act 1984, for the third party to be identified in the contract by name, class or description.

(4) Special illustrations which closely relate to the Chinese situation

Some of the special relationships that give rise to the insurance of limited interests should be considered here, especially those which are very close to the Chinese situation. However, in China, for the time being, there is no any law or case dealing with this, it is important to give a detailed examination in this stage.

A. Bailment

Bailment is a primary and common form under which the bailee has only a limited interest in the goods on bailment. At common law, the insurable interest of a bailee in the goods of which he is custodian, consists of, firstly, any liability of his to the bailor in the event of the goods coming to harm and, second, his own contractual entitlement to earned profits or commission for the performance of his services. In addition to insuring for his own interest, a bailee is also entitled by law to insure for the full value

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[270] S.49 (1)(d) of the ICA 1984 (Australia).
[271] The third party was allowed to claim directly from the insurer only where, as was discussed earlier, he could show specific statutory authority or that the insured contracted as trustee or agent for him.
[272] See s.1 of the Contracts (Rights of Third Parties) Act 1999 (UK).
[273] *Ibid.* s.1 (3).

for other persons interested provided that when the insurance is effected he intends to do so. In the sense of commercial convenience, the insurance to that extent is permitted apparently to lessen the risk to the bailor and thus to make the services of a bailee a more attractive proposition.[274] Where the insurance does cover the full value of goods and not just the liability or other interest of the bailee, it takes effect as one of the different interests of the bailor and bailee, so that the bailee is entitled to retain only those sums representing his own interest in the goods and must hold the balance on behalf of the bailor. The bailor could not make direct claim against the insurer under the common law, but the Contracts (Right of Third Parties) Act 1999 confers the bailor a right to do so.

Under the Australian ICA 1984, the case of bailor and bailee apparently falls into the category of section 49, so a bailee is allowed to insure up to the full value of the property on bailment. However, the situation is somewhat different from the common law position. First, under section 49, no positive intention to cover the bailor's interest appears to be required; it is enough if there is no positive intention to the contrary.[275] In other words, if there is insurance on property for its full value and there are two or more persons with separate interests in the property, the presumption is that the insurer and the insured intend to cover those other interests. Secondly, the bailee receives by way of indemnity only his actual loss, while the bailor on giving appropriate notice can claim the amount of his loss directly from the insurer, subject, of course, to the maximum sum covered.[276]

In China, the case of bailment is very common, but it seems that, so far, the insurance companies have not offered the forms of policy under which a bailee insures the full value of a property for not only his own interest but the bailor's as well.[277] The reason is that the Insurance Law does not give a bailee who has limited interest in the bailor's property an insurable interest for its full value. Similar relationships such as consignor

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[274] See the discussion by Lloyd J. in *Petrofina (UK) Ltd v. Magnaload Ltd* [1984] Q.B. 127.

[275] S.49(1) expressly states that the section does not apply where (c) the contract of insurance does not provide insurance cover in respect of an interest in the property that is not the insured's interest; and (d) before the contract is entered into, the insurer clearly informed the insured in writing that the cover does not extend to other interests.

[276] See s.49(3)(b), but the bailor is not able to obtain the payment until three months after the loss.

[277] Li Yuquan gives his comment on this point: "A bailee has an insurable interest on the property, but the interest is limited within his legal liability for the bailed property." See Li Yuquan, Baoxianfa (Insurance Law), p. 74, 1997.

and consignee, lessor and lessee and so on, the consignee and lessee can insure only for their contractual liability and commission or profit, they can not insure the full value of the property for other persons' interests who have interest in the property.

B. Vendor and purchaser

This special relationship on a selling house merits a more detailed examination, because, in China, the selling and buying of a house is a new booming business, especially in cities where the reform of dwelling houses has been undertaking. Before that reform, the workers of the state-owned enterprises were offered dwelling houses to live in by the enterprises they were working for. The workers did not need to buy houses themselves. In recent years, the Chinese government has been encouraging people to buy houses, and therefore matters relating to insurance in the course of selling and buying a house arise. The main problem of insurance for a selling house is insurable interest, *i.e.* when the vendor's insurable interest ceases and when the purchaser's insurable interest arises. So far, in China, no statute or statutory instrument in this respect has been enacted, and no issue has even been found on this question. However, some regulations for real property in the Urban Real Estate Administration Law of the PRC (hereinafter Estate Law))[278] might be helpful for the analysis of this question. Article 35 of the Estate Law provides: "where the land or building is transferred or mortgaged, the parties involved shall do the registration according to stipulation of Chapter 5." Article 60 continues: "... Where the land or building is transferred or exchanged, the parties shall apply for a registration for transfer or exchange in the Estate Administration Bureau of the local government, ..." In the absence of any other express provision or of any judicial construction, it could be submitted that these provisions have an implication that both legal title and risk pass to the purchaser at the same time as when the registration is made unless the parties contract otherwise. If this understanding is correct, the purchaser of the property shall have an insurable interest only after the registration has been made. If the building was burnt down before the title and the risk has passed to the purchaser (*i.e.* before the registration) but after the payment of the price, the vendor should return the price to the purchaser. However, if the vendor becomes insolvent, the purchaser

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[278] The Urban Real Estate Administration Law of the PRC was enacted in 1994, and as effective in January 1995.

would suffer the loss of the price. For this problem, there are good solutions in English law and Australian law, which could be used to fill up the omission in this respect in the Chinese Insurance Law.

In England, in common law, in regard to the sale of real property, between the signing of the contract of sale and the formal conveyance by deed, both the vendor and the purchaser may in certain circumstances have concurrent interests enabling each to insure and recover the full value of the property. As far as the purchaser is concerned, as a valid contract for the sale of a building, and in the absence of any express agreement to the contrary, the risk passes to the purchaser on the formation of the contract of sale,[279] although the law imposes a correlative duty on the vendor to maintain the property. Under common law, the vendor is liable to the purchaser if he wilfully damages or injures the property, or if he fails to take reasonable care of it.[280] It has been described as a duty to use reasonable care to preserve the property in a reasonable state of preservation and as it was when the contract was made.[281] Subject to the vendor's duty to take reasonable care to maintain the property, the purchaser, however, must bear all loss or damage to the property resulting from accident or natural disasters such as earthquakes, war hazards, or fire not caused by the vendor's fault or neglect. The purchaser must take a conveyance of real property and must pay the full purchase price for it even if the property has been damaged or destroyed in a way not caused by the vendor's fault or neglect after the contract has been entered into. It was held in *Rayner v. Preston*[282] that a purchaser is not entitled to insurance money paid to the vendor in respect of damage to the property occurring between contract and completion.[283] The passing of the risk gives the purchaser an insurable

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[279] *Paine v. Meller* (1801) 6 Ves. 349; *Poole v. Adams* (1864) 10 L.T. 287

[280] *Phillips v Lamdin* [1949] 2 K.B. 33, [1949] 1 All E.R. 770.

[281] *Clarke v. Ramuz* [1891] 2 Q.B. 456, C.A. See generally [1971] L.S.G. 224 (Professor J.E. Adams), [1988] Law Com WP No 109, paras 1.27-1.35, the subsequent provisions of the Standard Conditions of Sale, Law Commission and the later Report Law Com No. 191 (The later Standard Commercial Property Conditions did not follow those earlier conditions on this aspect). As to the vendor's duty to take care of the selling property between contract of sale and completion of the conveyancing see Mark Thompson, Barnsley's Conveyancing Law and Practice, (4th ed.), pp. 245-250, 1996.

[282] (1881) 18 Ch. D. 1.

[283] According to some statutes, the purchaser seems to have the benefit from the vendor's insurance, but the purchaser is still presumed to have an insurable interest for the property after the conclusion of the contract of sale. Under the Fires Prevention (Metropolis) Act 1774 (UK), s. 83, an insurance company is required, in the case of loss or damage *by fire,* to take steps to bring about reinstatement of the insured property upon the request of any person interested in or entitled to it, provided the insurers have not already paid out to the insured. A mortgagee is a person interested (see *Sinnott v. Bowden* [1912] 2 Ch. 414), but there is no decision on the rights of a purchaser under a contract for sale. It is generally felt

interest in the property for its full value in respect of his risk and of his liability to pay the full price for the property which, when conveyed to him, may have become valueless.[284]

As far as the vendor is concerned, the insurable interest of the vendor of the building is retained for his lien for the purchase money until the completion of the contract, or the receiving of full payment of the purchase price [285]. In addition, it is his responsibility to take care of the property, and this also gives the vendor an insurable interest on the property.

Under Australian ICA 1984, the legal position under common law in respect of vendor and purchaser has been altered by section 50, which, to the extent of any inconsistency therewith, overrides the various legislative attempts to mitigate the hardship caused to purchasers by the common law approach. Section 50 provide: (1) Where:

(a) a purchaser agrees to purchase, or to take an assignment of, property and in consequence the purchaser has, or will have, a right to occupy or use a building;

(b) the building is the subject-matter of a contract of general insurance to which the vendor or assignor under the agreement is a party; and

(c) the risk in respect of loss or damage to the building has passed to the purchaser, the purchaser shall be deemed to be an insured under the contract of insurance, so far as the contract provides insurance cover in respect of loss of or damage to the building and such of the contents of the building as are being sold or assigned to the purchaser at the same time, during the period commencing on the day on which

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that this section, assuming it extends to purchasers (supported obiter by James L.J. in *Rayner v. Preston* (1881) 18 Ch. D. 1 at 15, C.A.), does not afford adequate protection and tends to be ignored by conveyancers.

S. 47 of the Law of Property Act 1925 (UK), enacts, in effect, that the purchaser is to have the benefit of any insurance money payable to the vendor after the date of the contract in respect of any damage to or destruction of the property, provided (a) there is no contrary stipulation in the contract between the parties, (b) the insurers give their consent (and in many but not all household policies it is given in general terms, though a purchaser will not know this without a specific inquiry) and (c) the purchaser pays a proportionate part of the premium from the date of the contract. In spite of this provision, the advice given in all the books is that the purchaser should insure. See Mark Thompson, Barnsley's Conveyancing Law and Practice, (4th ed.), p.253, 1996. See also the Sale Conditions mentioned in note 281, above.

[284] *White v. Home Insurance* (1870) 14 Low. Can. Jur. 301. This case is used to support the point in MacGillivray on Insurance Law although it is not an English case, see, 9th ed., para. 1-126, 1997.

[285] *Collingridge v. Royal Exchange Ass. Corp.* (1877) 3 Q.B.D. 173; *Ziel Nominees Pty. Ltd v. V.A.C.C. Ins. Ltd.* (1976) 50 A.L.J.R. 106.

the risk is passed over and ending at whichever of the following times is the earliest.

(d) the time when the sale or assignment is completed;

(e) the time when the purchaser enters into possession of the building;

(f) the time when insurance cover under a contract of insurance effected by the purchaser in respect of the building commences;

(g) the time when the sale or assignment is terminated.

It is clear that the purchaser may enjoy the protection of the vendor's insurance from the day on which the risk passes to the purchaser (which is normally at the time of entry into the contract of sale) and continues until the sale is completed, or the purchaser enters into possession, or the purchaser himself arranges insurance cover for the building, or the contract of sale is terminated – whichever event is the earliest in time. It seems that the Australian approach is more reasonable and it really mitigates the purchaser's unfavourable position in common law. However, as was noted above, if the provisions in the Urban Real Estate Law of PRC[286] really imply that the risk and the ownership of a building pass to the purchaser at the same time as the registration is made, the approach adopted in section 50 of the Australian ICA 1984 will have no operation in China. However, it is suggested, if the contract of the sale of a building contains a clause that the risk passes to the purchaser when the contract is concluded, and where the vendor has effected a policy on the building, the Australian approach should be adopted by Chinese courts to mitigate the purchaser's position.

C. Mortgagor and mortgagee

It is convenient to associate insurable interest with the relationship of mortgagor and mortgagee when talking about the sale of a house. When a person buys a house, he may mortgage the house to a building society or a bank for a loan. Insurance protection is immediately involved in this situation. In China, as was just discussed, more and more people are buying houses with the help of bank loans upon the mortgage of the house. So far as the insurable interest is concerned, both mortgagor and mortgagee have an insurable interest in the mortgaged property, for both of them

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[286] Arts. 35 and 60 of the Urban Real Estate Law 1994 (PRC).

have a legally recognised interest in it. This satisfies the requirement of article 11 of the Insurance Law where it requires a proposer to possess a legally recognised interest in the property insured. So each of them may take out a separate and independent insurance for his own interest,[287] and in each case the property insured is the particular interest of the insured in the subject matter covered by the policy. On settlement in the event of loss, no insured can receive for his own benefit more than the amount of loss sustained by him in respect of his interest. Turning the topic to 'limited interest', difficult questions might arise as to the extent of the insurable interest. A mortgagee (a building society or a bank) legally has an insurable interest in the mortgaged property to the amount of the debt secured on it, but whether or not its insurable interest may extend to the full value of the property for both its own and the mortgagor's benefit is doubtful.

In England, a mortgagee who has a limited interest in the mortgaged property may insure it for its full value and recover the full amount of any loss to himself and the mortgagor. As was examined earlier, since the LAA 1774 has been held to have no application to indemnity insurance,[288] a mortgagee has, by reason of his interest in the property and the commercial sense of his position, the right to insure it for its full value for the benefit of the mortgagor. In the event of loss he holds the insurance proceeds in excess of his own interest on trust for the mortgagor.[289] The rules which are followed in goods insurance apply also to the real property insurance, namely, whether or not the policy covers the interests of both parties is a question of construction and the third party can sue directly against the insurer under the Contracts (Rights of Third Parties) Act 1999, unless deleted that right in the contract.[290] Under the ICA 1984 of Australia, the question of insurable interest in the relationship of

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[287] In China, in practice at present, when the bank makes a loan to the purchaser of a house which is under the mortgage, the purchaser is forced to buy insurance on the house for the bank's benefit as a condition to get the loan. The bank does not take out insurance on the mortgaged property, if the property is damaged or destroyed, the bank get the payment from the insurance company first, and the surplus goes to the insured owner of the house.

[288] See MacGillivray on Insurance Law, (9th ed.), pp. 66-67, paras. 1-154 and 1-155, 1997. See also *supra* s. 4.2(1) of this Chapter "Insurable interest in real property" for the detailed examination.

[289] *Tomlinson (Hauliers) Ltd v. Hepburn* [1966] A.C. 451, at 480; *Petrofina (UK) Ltd v. Magnaload Ltd* [1984] Q.B. 127, at 136.

[290] The 1999 Act changed the third parties' legal position of common law under which he was not allowed to sue the insurer directly.

mortgagor and mortgagee is the same as the relationship of bailor and bailee which was discussed earlier.[291]

Having examined the approaches of English law and Australian law in respect of limited interest, it is suggested that in China, where the mortgagee has covenanted to insure, he should be held to have an insurable interest for the full value of the mortgaged property, and can insure the property for his and the mortgagor's interests, provided he intended to do so when the policy was effected.[292] As long as the intention that the mortgagor is covered in the policy is clear, and the mortgagor should be allowed to seek insurance money directly from the insurer for the surplus of the proceeds of the insurance after the mortgagee has been indemnified.

However, where a person insures for other persons' interests but the other persons do not know that they have been covered under the policy, it is possible that they themselves will have taken insurance on the same subject matter, and thus the problem of double insurance may be caused. That question is beyond the scope of this thesis.

(5) Limited interest in property and insurable interest

It has been noted that all these cases, either in English common law or in the Australian Act dealing with limited interests, have been concerned with limited legal or equitable interests in the insured property. However insurable interest in a property is not necessarily confined to legal or equitable interest; whether or not a person with a limited interest has an insurable interest on the whole property depends on what the test of insurable interest is. As was examined earlier, in England and Australia two different tests of insurable interest have been adopted. In English law, the strict proprietary interest test has been adopted, while in Australian law, the ICA 1984 overturned the strict test and adopted the economic or pecuniary test[293]. It is not difficult to understand that under the economic interest test of insurable interest, a person having a limited interest in a property is allowed to insure it for its full value,

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[291] See *supra* s. 4.5(3) of this Chapter "the Australian approach".
[292] For this question, it is submitted that the English view that the insured's intention of covering other persons interest except his own interest must be shown is preferred to fit into the Chinese situation, simply because, by doing so, the insured's real intention will be clearly expressed.
[293] S.17 of the ICA 1984 (Australia)

for if the property is destroyed he will suffer an economic loss. Let us still take the example of bailor and bailee; under the strict legally recognised interest test, his insurable interest is confined to his interest recognised by law, and he therefore can only take out insurance for his legal liability on goods he is looking after or for his commission on the goods. If the economic interest test is taken as a criterion, the bailee is permitted to insure the full value of the goods, because he would suffer an economic or pecuniary loss as a result of the destruction of or damage to the property bailed to him. Presumably, this would include loss of prospective profits such as commission if the policy were wide enough to cover this.[294]

In England the strict proprietary interest has been adopted, but why is it that a person with a limited interest in a property may insure its full value? That is because in England goods insurance is expressly outside the mischievous kind of gaming which the LAA 1774 intended to prevent. So such insurances are not regulated by that Act. Goods insurance may be effected as long as it satisfies the Gaming Act 1845, section 18 and the principle of indemnity. Contractually the insured must have an interest at the time of loss to meet the requirement of the principle of indemnity and the value of his interest is crucial. He *prima facie* recovers only sufficient to indemnify him. However, since the principle of indemnity is merely an implied incident of every contract of indemnity, there is nothing to stop the parties from dispensing with it. The contractual requirement may be waived or dispensed with by a contract between the parties.[295] So there are certain circumstances in England where a person with a limited interest could insure for and recover the full value of the subject matter of the insurance. So far as real property is concerned, since the LAA 1774 has been held to have no application to indemnity insurance, the same rationale underlying limited interest on goods applies to that in real property.

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[294] He possibly loses commission if the goods are destroyed by an insured event, at least in a commercial bailment.

[295] There are authorities in England which illustrate the point of waiving of the contractual requirement of insurable interest. See *Prudential Staff Union v. Hall* [1947] K.B. 685; and *Thomas v. National*

4.6 Insurable interest and co-insurance

Another possible form in which a person with limited interest is allowed to insure a whole property in which more persons are interested is co-insurance. Co-insurance has been more and more widely applied in the modern insurance industry. This type of insurance is more complicated than a simple insurance as it involves two or more insureds in a single policy. Co-insurance policies have also been used in China's insurance market, but their application is not as wide as that in England or Australia. The typical co-insurance policies which have been used in China are the policies of Contractor's All Risks and Erection All Risks.[296] Some other co-insurances, such as insurance for mortgagor and mortgagee, bailor and bailee or landlord and tenant, have not been used. As a matter of law, co-insurance has not been touched either in Chinese legislation or in judicial decisions.

In England, co-insurance is widely used in practice and many judicial decisions have been made in this context. Especially in recent years more and more arguments involving co-insurance have been submitted to English courts. The issues on this type of insurance are focused on the concept of insurable interest and the principle of subrogation. The prevailing approaches for these issues are that, firstly, a co-insured is immune from the subrogation action of an insurer, and, secondly, a co-insured has an insurable interest in the entire property insured under a co-insurance policy.[297] The first point will be discussed in the topic of "subrogation". The second point, *i.e.* insurable interest in co-insurance, is considered here.

(a) Creation of a co-insurance

Two or more persons being insured under a single policy creates a co-insurance. There are two forms of co-insurance. (1) two or more persons take out insurance together in a single policy to cover their respective interests; (2) one person who has a limited interest effects a policy on behalf of himself and others who are interested in

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Farmers' Union mutual Insurance Society [1961] 1 W.L.R. 386. Matters about the waiver of insurable interest, see further J. Birds, Modern Insurance Law, (4th ed.), p.58, 1997.

[296] See PICC's Constration All Risks Insurance Policy and Erection All Risks Insurance Policy.

[297] *Petrofina (UK) Ltd. v. Magnaload Ltd.* [1984] Q.B. 127; *National Oilwell (UK) Ltd v. Davy Offshore Ltd.* [1993] 2 Lloyd's Rep 582.

the property. The other persons can be named in the policy or fall into a class described in the policy. The question of what interests are covered by a particular policy is primarily a question of fact depending on the intention of the parties when the contract is effected. Many situations may create co-insurance, such as mortgagor and mortgagee, landlord and tenant, contractor and sub-contractor, consignor and consignee as well as partnership.

In England, in common law, where a person take out a co-insurance, the following conditions must be satisfied:

(1) His authority is extended to making the contract in question; and

(2) He intended, when taking out the policy, to cover others' interests; and

(3) The policy does not preclude the extension of coverage to others.

Point (1) means that where A insures for his own interest and B's interest, A has to obtain the authority from B to insure on B's behalf by either an express term or an implied term in a contract between A and B in a contractual obligation on A to insure the interests of B on the basis that obligation equals authorisation. If A has no authority from B, A's intention is not assumed to cover B's interest. The point is best illustrated by the case of *Stone Vickers Ltd v. Appledore Ferguson Shipbuilders Ltd.* [298] In this case, a contractor's all risks policy was effected by the head contractor stating that it covered the interests of the head contractor and subcontractors, and the subcontractors are the co-insureds. The Court of Appeal held that, despite the clear intention of the policy to cover subcontractors, the subcontractor in question was not an insured party as the various indemnities given by the subcontractor to the contractor in the subcontract were inconsistent with any authorisation to the contractor to insure on the subcontractor's behalf. Where A's authority to insure on behalf of B is limited to particular risks, B can be regarded as co-insured only in respect of those risks. The case of *National Oilwell (UK) Ltd v. Davy Offshore Ltd.*[299] clearly demonstrated this point.

However, if A is not authorised to insure on behalf of B, the remedy is that B may take advantage of the contract by means of ratification. In non-marine insurance, the

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[298] [1992] 2 Lloyd's Rep 578.
[299] [1993] 2 Lloyd's Rep 582.

ratification must take effect before B became aware of the loss. This was the decision of the traditional case of *Grover & Grover Ltd v. Mathews*[300]. In that case the plaintiffs insured their piano factory through an agent at Lloyd's. Without consulting them, the agent wrote seeking renewal of the policy when it expired. A fire happened after this expiry and after the agent wrote, but before the plaintiffs knew what the agent had done. When they did find out, they purported to ratify his acts. It was held that the ratification was too late and the insurers were not liable. As far as marine insurance is concerned, MIA 1906, section 86, provides that a person on whose behalf a contract of insurance has been made may ratify that contract even after he has become aware of the loss. The distinction between marine and non-marine law has nevertheless been criticised *obiter* by Colman J in *National Oilwell (UK) Ltd v. Davy Offshore Ltd*, [301] the learned judge there suggesting that the more liberal marine rule should apply to all classes of insurance and that ratification after knowledge of loss should be permitted.

With regard to point (2), if A is authorised or required by B to insure for B, and A's intention is not to cover B, he is likely to be in breach of contract and may face an action from B in the event that B finds himself uninsured for a particular loss[302] or facing a subrogation action brought by A's insurers in A's name.

If the above two points are satisfied, point (3) raises the question of the construction of the policy. If B's name is inserted in the policy or if B falls into the class described in the policy, B is a co-insured. However, the problem is where B is not identified in the policy; in other words, if the policy is silent as to insureds, but A intended to insure B's interest, is B a party in policy? This problem was solved in the case of *Siu Yin Kwan v. Eastern Insurance Co. Ltd.*[303] In that case the Privy Council held that based on the finding that the agents clearly had actual authority to effect the insurance on

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[300] [1910] 2 K.B. 401.
[301] [1993] 2 Lloyd's Rep 582, at 596-7.
[302] See *Naumann v. Ford* [1985] 2 E.G.L.R. 70. In this case, the defendant landlord had covenanted with the plaintiff tenant to insure the demised premises against fire and to apply the insurance moneys in reinstating the premises. A policy, issued by Norwich Union, was procured by the landlord, but it lapsed shortly before the occurrence of a fire. Subsequently Norwich Union reached an agreement with the tenant whereby it was to pay for the cost of repairs but the tenant was to sue the landlord for breach of the insuring covenent and to hold the proceeds of that action – doubtless equaling the cost of repairs – on trust for Norwich Union.
[303] [1994] 1 All E.R. 213. See p. 137 for detailed examination of this case.

behalf of the ownershipers, the ownershipers were treated as parties to the policy under the doctrine of the undisclosed principal.

Under a co-insurance, each co-insured has a right to claim against the insurer, while how to dispose of the insurance money is in essence a matter of contract. If the contract provides that the insurer must make payment jointly to all insureds, he must do so, and it is for those insureds to allocate the moneys between themselves in accordance with losses suffered.[304] Alternatively, the policy may permit each insured to claim against the insurer in respect of his own interest.[305]

(b) Insurable interest in co-insurance

There are two types of co-insurance, joint policy[306] and composite policy[307]. In the case of a joint policy, the insurable interests of the joint insureds are identical, and extend to the entire subject matter insured. This means that either party has an insurable interest in the full value of the joint property and can recover the full amount insured under the policy. As far as a composite policy is concerned, such as the contractor's all risks policy, the view is that each co-insured has a full insurable interest in the entire works despite limited proprietary or possessory rights. This view was clearly expressed in some recent cases. *Petrofina (UK) Ltd v. Magnaload Ltd.*[308] and *National Oilwell (UK) Ltd v. Davy Offshore Ltd.*[309] were both involving contractor's all risks policies. In both cases it was held that a subcontractor had an insurable interest in the entire contract works even though he was actually insured only in respect of a part of them, despite the fact that the main issues in both cases were the matters of subrogation, *i.e.* whether or not a co-insured under a contractor's all risks insurance may be immune from a subrogation action.[310] The question of whether or not a co-insured may recover the full amount of a loss is not very clear. It could be

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[304] *General Accident Fire and Life Assurance Corporation Ltd v. Midland Bank Ltd.* [1940] 2 K.B. 388 at p.415, per Sir Wilfrid Greene MR.

[305] See R. Merkin, Insurance Contracts Law, in loose-leaf, p. A.4.6-14.

[306] If the co-insureds share a common interest in the insured subject matter, their interests are in an undivided whole, *i.e.* where they are joint owners of property, such as a husband and wife or a partnership, the policy is joint.

[307] If the co-insureds have different interests, and their interests are divisible, such as mortgagor and mortgagee or contractor and subcontractors, the policy is composite.

[308] [1984] Q.B. 127.

[309] [1993] 2 Lloyd's Rep 582.

[310] Matters about subrogation will be fully discussed in Chapter five "Subrogation".

inferred from these decisions that each co-insured is allowed to recover the full amount because he is presumed to have an insurable interest in the entire works.

It is submitted that co-insurance has several advantages as far as both insureds and insurers are concerned:

(1) This form of insurance has commercial convenience. For example, for a construction insurance, it is common practice in the building industry for the head contractor on a site to insure, in his name and on behalf of subcontractors (and often on behalf of the owner/developer, too), the entire contract works against all risks under the contractor's all risks policy. As there may be a diversity of property on site, with a multitude of different owners, and requiring separate insurance would in a large operation inevitably give rise to overlapping policies as well as to great uncertainty in respect of who exactly is the owner of which piece of property at any given time.

(2) It saves insureds' time and money. If every interested party in a project were to take out insurance for his own interest, it would inevitably take more of the owner's, the contractor's and the subcontractors' time and waste more of their moneys on premiums. To solve this problem by effecting co-insurance can save time and money.

(3) It also saves the insurers time, expenditure and labour by covering two or more co-insureds in a single policy instead of covering them by effecting more separate policies.

(4) It reduces subrogation claims. In practice, many subrogation actions are undertaken between one insurer and another rather than that between the insurer and the wrongdoer. Under a co-insurance policy where different interests are covered in a single policy, including property insurance and liability insurance, a co-insured who negligently causes property damage or bodily injury to other co-insureds is immune from the insurer's subrogation because they are covered by the same insurer.

(5) It can avoid a gap of time during which the goods might be left uninsured, *e.g.* between the goods starting to be transported from the owner's warehouse and arriving at the bailee's warehouse.

It is therefore suggested that matters of co-insurance should be covered in the Chinese Insurance Law when it is amended.

4.7 When insurable interest is required in property insurance

In China, the Insurance Law does not expressly stipulate when insurable interest in property insurance must exist; nevertheless, article 11 of the Insurance Law seems to require a proposer to hold an insurable interest in the property insured at the time when the contract is concluded, because it is said that an insurance contract shall be void where the proposer has no insurable interest in the insured subject matter. Further, due to the application of the principle of indemnity, he is also required to show the interest at the time of the occurrence of the loss. So according to article 11 of the Insurance Law and the principle of indemnity, it could be determined that, in China, the insurable interest in property insurance is required at both the time when the policy is effected and the time when the loss occurred. However, some Chinese scholars have different points of view in this respect. Professor Xu agrees with the above view,[311] but Dr. Li has the different view and says that insurable interest is not necessary to exist when the policy is effected, it is required only at the time of loss.[312]

In England, for goods insurance, generally, insurable interest is not required at the inception of the contract, as long as it is not a gaming or wagering contract which falls foul of section 18 of the Gaming Act 1845.[313] However, it is essential for him to show that at the time of loss he has suffered a loss resulting from the destruction of the subject matter insured to satisfy the principle of indemnity under which the insured may not recover more than he has lost.[314] As far as insurance in real property is concerned, it was at one time thought that the LAA 1774 applies. Accordingly, the insurable interest was required at the time the policy was effected. Since the decision of *Mark Rowlands Ltd v. Berni Inns* [315] in which it was held that the 1774 Act applied only to life policies and did not and does not extend to indemnity insurances, the requirement of insurable interest at the time when the contract was concluded has been removed, and the rules applying to goods insurance have been followed in real

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[311] See Xu Xuelu, Baoxianfa (Insurance Law), p. 55, 2000.
[312] See Li Yuquan, Baoxianfa (Insurance Law), p. 76, 1997.
[313] S.18 is effective against any policy under which the insured has neither an insurable interest nor an expectation of acquiring such an interest at the date of the inception of the policy.
[314] *Anderson v. Morice* [1876] 1 App. Cas. 713; See also R. Merkin, Colinvaux's Law of Insurance, (7th ed.) p.67, 1997 for the detailed analysis. See also Hardy Ivamy, General Principles of Insurance Law, (6th ed.) p.27, 1993.
[315] [1985] 3 All E.R. 473, approved by the Privy Council in *Siu Yin Kwan v. Eastern Insurance Co.* [1994] 1 All E.R. 213 (Liability insurance).

property. Thus it could be concluded that all indemnity insurances require an insured to possess an interest in the subject matter insured when the loss occurs. This conclusion applies to the corollary that proof of loss necessarily involves proof of an interest in the subject matter since if there is no interest there can be no loss.

Section 16 of the Australian ICA 1984 expressly provides: "A contract of general insurance is not void by reason only that the insured did not have, at the time when the contract was entered into, an interest in the subject-matter of the contract." This section dispenses the requirement for insurable interest at the inception of policy, but it says nothing about an insurable interest being insisted upon at the time of any loss. However, from section 17 the requirement of an interest at the time of loss is reflected. Section 17 requires the insured to establish a pecuniary or economic loss arising from the damage or destruction of the subject matter of insurance. This means that in general insurance, an insured must have an insurable interest at the time of loss, for it can be said that proof of loss is equivalent to proof of interest.

It can now be concluded that the requirement of insurable interest in indemnity insurance is not necessary at the inception of a policy. The reason is that the purpose of indemnity insurance is to indemnify the insured for his actual loss when an insured event occurs. Whether or not he suffered a loss or how serious a loss he suffered must be determined at the time of loss of the subject matter insured. Provided he can establish that he has suffered loss as a result of an event insured against, he can recover from the insurer. So it is suggested that the Insurance Law should make it clear that in property insurance, an insured is required to have an insurable interest only at the time of loss of the subject matter insured.

4.8 Conclusion and suggestions for insurable interest in property insurance

As analysed above, the Insurance Law does not give detailed provisions relating to insurable interest in property insurance. Consequently, difficulties may be caused in insurance practice and in judicial matters. The only provision which can be followed when dealing with matters of insurable interest in property insurance is article 11. The key question in article 11 is the test of insurable interest, the strict application of the legally recognised interest can lead to unjust results. It is suggested that the economic

test of insurable interest adopted in Australian ICA 1984 be introduced. If the economic interest test were to be accepted in China, the question of whether a person who has a limited interest may insure for other persons would have a positive answer. It is also suggested that some provisions relating to insurable interest in property insurance should be added into the Insurance Law by introducing or referring to some English or Australian approaches.

5. Insurable Interest in Marine Insurance

The principle of insurable interest is also important in marine insurance. Unfortunately, the Maritime Code 1992 (PRC) does not make any provision relating to insurable interest. Matters of insurable interest in marine insurance are covered in article 11 of the Insurance Law, for article 147 of the Insurance Law expressly declares: "Marine insurance shall be governed by the relevant provisions of the Maritime Code. Matters not provided for in the Maritime Code shall be governed by the relevant provisions of this law." However, due to the special nature of ocean transport and international trade, in many aspects, marine insurance is different from other types of insurance, so article 11 of the Insurance Law is unable to satisfy the need of insurable interest in marine insurance. In contrast, the MIA 1906 (UK) has been regarded as a model in the legislation of marine insurance world-wide, and has been followed by countries where there is no marine insurance law or their own law cannot satisfies the need in practice. It is therefore suggested that matters of insurable interest in marine insurance should be stipulated in the Maritime Code by referring to the provisions in respect of insurable interest in the MIA 1906 (UK) where article 11 of the Insurance Law is not sufficient to meet the practical need in marine insurance.

One article of the Maritime Code (PRC) need to be considered here which might be deemed to have some connection with insurable interest in marine insurance. Article 218 of the Maritime Code provides: the following items may come under the subject matter of marine insurance:

(1) ship;

(2) cargo;

(3) income from the operation of the ship including freight, charter hire and passenger's fare;
(4) expected profit on cargo;
(5) crew's wages and other cargo;
(6) liabilities to a third person;
(7) other property which may sustain loss from a maritime peril and the liability and expenses arising therefrom.

The insurer may reinsure the insurance of the subject matter enumerated in the preceding paragraph.

According to this article and coupled with article 11 of the Insurance Law, it could be concluded that persons with a legally recognised interest in the items mentioned in this article are assumed to have insurable interest in them.[316] For instance the owners of the ship or cargo, the carrier's liability for the cargo and etc. As the underlying principle is the same in all types of cases, it is unnecessary to examine the position of each and every one of these persons. Two special topics on insurable interest in marine insurance will be discussed in this section, namely the "positions of the seller and the buyer of goods" and "when insurable interest must attach in marine insurance".

5.1 Positions of seller and buyer of goods

In marine insurance, as a matter of practice, one of the most popular types of insurance is "ocean marine cargo insurance".[317] As far as insurable interest in this type of insurance is concerned, the most difficult question is that at what point of time the insurable interest is transferred from the seller to the buyer in the transit of the goods. As was considered earlier, the simplest and most basic form of insurable interest in property insurance is the ownership of the subject-matter insured, no matter which test (the strict proprietary test or economic test of insurable interest) is adopted. Generally speaking, this rule also applies to marine insurance, but in some special situations this rule should not be applied rigidly in marine insurance, as sometimes, when the loss

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[316] This was discussed with Song Haiwen when I did my fieldwork in China. He was a judge of Qingdao Maritime Court then and was doing his Master Degree by research on "the Insurable Interest in Marine Insurance."

occurs, the person who suffers the loss is not the owner of the goods but the other person. If insurable interest is confined to the ownership of the goods, it is bound to cause difficulty for the seller or buyer to arrange insurance for their goods. For example, during the course of a sale of goods, strictly speaking, the buyer, who has yet to acquire possession or ownership of the goods, cannot insure them in transit, but where the risk is transferred to him from the seller, which is usually from the time of shipment, he is presumed to have an insurable interest on the goods. Until shipment, he stands in no legal or equitable relation to the goods.

In international trade, where parties (seller and buyer) are contracted under the terms of trade of FOB (Free on Board) or C & F (Cost and Freight), and CIF (Cost, Insurance and Freight),[318] the risk passes to the buyer from the seller usually at the time of shipment, and the buyer then has an insurable interest in the goods after shipment, because from that time he is bound to pay the price to the seller even if the goods are lost or damaged. The rule that the passing of the risk gives insurable interest makes it convenient for the buyer to take out insurance for his prospective goods before he obtains the property in them. However there are different views concerning the point in time of passing the risk from seller to buyer. Professor Malcolma Clarke comments: "Once risk has passed, it is clearly beyond doubt that damage to the goods will damage the buyer; that is what really matters. The line has been clearly drawn; however, it is not clear at all how to explain it to the buyer. The buyer is unlikely to understand why the line is drawn at the point of shipment rather than earlier, for example, in the seller's factory when the goods are being packed."[319] It is submitted that, if parties agree to pass the risk earlier than the shipment, it is not impossible to do so.

However, the interest might revert to the seller in special situations. That is the case which is dealt with in section 7 of the MIA 1906 (UK), and which is called "contingent or defeasible" interest. Section 7 offers two examples of contingencies which could cause the reversion of the interest from the buyer to the seller: "(1) A defeasible interest is insurable, as also is a contingent interest; (2) In particular, where the buyer

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[317] One of the other most popular policies is hull insurance.
[318] According to the "International Rules for the Interpretation of Trade Terms of 1990 (Incoterms 1990)
[319] See M. Clarke, Policies and Perceptions of Insurance – An introduction to insurance law, p.30, 1996.

of goods has insured them, he has an insurable interest, notwithstanding that he might, at his election, have rejected the goods, or have treated them as at the seller's risk, by reason of the latter's delay in making delivery or otherwise[320]." A defeasible interest is one which is liable to be defeated by subsequent events. Until the transit is completed, the seller may wish to exercise his right of stoppage in transit should he be unpaid. The buyer's interest could be defeated or forfeited by the action of the seller. Even though his interest may be defeasible, at the option of the unpaid seller, this does not prevent him from insuring his interest.

On the other hand, the buyer of goods always has the right to reject the goods if they are found on arrival not to comply with the terms of the sale, for example, that they are not of merchantable quality. Thus, even though the interest in the goods may already have passed to the buyer, nonetheless, it could still revert to the seller should the buyer exercise his right of election to reject the goods. It is in this sense that the buyer's interest in the goods is contingent; his interest is dependent upon certain contingencies. Despite the contingency of the interest the buyer still may insures the goods after the shipment. Next question is when the insurable interest must exist.

5.2 When interest must attach

Article 11 of the Insurance Law only requires a proposer to have an insurable interest as a condition of the validity of an insurance contract, and it does not expressly stipulate the time when the insurable interest must be attached. As analysed earlier, this article seems to require that the proposer must hold an interest at the inception of the policy. It is not a matter of doubt that this requirement does not apply to the nature of marine insurance, for it is often the case that, when a policy is effected, the proposer does not have an interest in the subject-matter insured. For instance, where goods are insured by the buyer prior to shipment, the property or risk has not passed to him, and he therefore has no interest in the goods, but he must show he has an expectation of acquiring the interest and when the event insured against occurred he must has an interest, *i.e.* he must prove he has suffered a loss, because he cannot recover if he has not suffered.

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[320] See Professor Merkin, Annotated Marine Insurance Legislation, p.7, 1997.

Based on the nature of marine insurance, the MIA 1906 (UK) expressly stipulates that an insurable interest subsisting at the time of loss is sufficient. Section 6 reads:

(1) The assured must have interest in the subject-matter insured at the time of the loss though he need not be interested when the insurance is effected;

Provided that where the subject-matter is insured "lost or not lost", the assured may recover although he may not have acquired his interest until after the loss, unless at the time of effecting the contract of insurance the assured was aware of the loss and the insurer was not.

(2) Where the assured has no interest at the time of the loss, he cannot acquire interest by any act or election after he is aware of the loss.

This section established the rule that an insurable interest existing at the time of loss is sufficient. As one authority comments "it is every day's practice to effect insurances in which the allegation of interest at the time of effecting the policy could not be made with any degree of truth, as, for instance, where goods are insured on a return voyage long before they are bought."[321] However, the proviso to s.6(1) allows a person who has become interested after the loss to recover when the loss in question falls on him where there is a 'lost or not lost' clause in a policy. The only condition which would bar him from recovery is if, at the time of effecting the contract of insurance, he was aware of the loss and the insurer was not. The standard policy on the S.G. form contained this provision. The "Lost or not lost" clause no longer appears in the new insurance documentation introduced in 1982 and 1983; instead clause 11 of the Institute Cargo Clauses addresses the point in different language. It reads :

11.1 In order to recover under this insurance the Assured must have an insurable interest in the subject-matter insured at the time of the loss.

11.2 Subject to 11.1 above, the Assured shall be entitled to recover for insured loss occurring during the period covered by this insurance, notwithstanding that the loss occurred before the contract of insurance was concluded, unless the Assured were aware of the loss and the Underwriters were not.

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[321] See Arnould's Law of Marine Insurance and Average, (16th ed.), p.223, edited by Raoul Colinvaux, 1981. In the latest edition (16th ed, 1997), vol.3, edited by J.C.B. Gilman, there is no change for this point.

It is clear that in the new clause the words "the assured may recover for the loss occurred before the contract of insurance was concluded" are substituted for those "he may recover although he may not have acquired his interest until after the loss" which was adopted in the standard policy on the S.G. form and in section 6(1) of the MIA 1906. It seems from clauses 11.1 and 11.2 that the insures must have an interest at the time of loss in any event, for clause 11.1 so requires and clause 11.2 does not create any exception to the requirement stipulated in clause 11.1. Accordingly, the insured can not recover if his interest was acquired after the loss has occurred even though he did not know the loss had occurred when the policy was effected. Clause 11 is clearly narrower in scope than section 6(1) of the MIA 1906, for the latter allows a person to recover although he may not have acquired his interest until after the loss. It is submitted that the new clause is more reasonable because it allows the insured to recover for the loss which had occurred before the contract was made but not for the loss which had occurred before he acquired an interest in it. If he had not acquired an interest when the loss occurred he suffered nothing, he therefore should not recover. So it is suggested that the insurable interest must attach at the time of loss.

6. Conclusion

This chapter made a detailed analysis of the provisions relating to the whole question of insurable interest in the Insurance Law. At the same time, the approaches of English and Australian law relating to insurable interest were examined. The general conclusion is that, on the one hand, in some respects, the Insurance Law made a lot of progress by giving some provisions for insurable interest in life insurance, especially for the protection of the life insured such as article 54 which prohibits a policy being made on a person without a capacity of civil acts and 55 which requires the written permission of the life insured where a death policy is effected. It also establishes rational categories of insurable interest in lives of family relationship which is in agreement with the Chinese Marriage Law. However, on the other hand, a number of problems were found. First of all, the Insurance Law produces ambiguity and self-contradiction in articles 52 and 55 in respect of requirement of insurable interest and requirement of the life insured's consent in life insurance. Secondly, due to the ambiguity of provisions in respect of the matter of the beneficiary, a number of

arguments have been caused in practice. Thirdly, there is a lack of detailed provisions for insurable interest in property insurance. As a result, difficulties may be caused for courts when they deal with the arguments arising from this context. Fourthly, the requirement of the legally recognised interest on a proposer (article 11) and the view that the proposer and the insured may be different persons (article 21) are completely contradictory. This causes difficulty in ascertaining whether or not a person with a limited interest or without any interest in a particular property is allowed to insure for other persons' interests. Finally, there is no provision in regard to insurable interest in Maritime Code for marine insurance, and article 11 of the Insurance Law cannot meet the need for marine insurance. It is suggested that these lacunae need to be filled up.

After the examination of English Law and Australian Law relating to the principle of insurable interest, better approaches have been found which it is suggested can be taken as a reference to amend Chinese insurance law. Recommendations for amendments to Chinese law are made which can be seen in Chapter six.

Chapter Four: Non-Disclosure and Misrepresentation

1 Introduction

It is well known that an insurance contract is a contract *uberrimae fidei* - of utmost good faith, *i.e.* each party is under a duty to exercise the utmost good faith towards the other in respect of any matter arising under or in relation to the contract. Perhaps the most important consequence of the *uberrimae fidei* principle is the doctrine of disclosure. During the negotiations for a contract of insurance both parties are under a duty to volunteer to each other information which is material to the risk and which is not known by the other party.

Utmost good faith is a very important principle in insurance law. Every country codifies this principle in its own insurance law in different ways.[1] The principle of itself has stood in an unchallenged position in governing insurance activities since its birth. Some doctrines derived from it and the ways of their application in practice have, however, raised arguments. For example, in England, the wide-ranging voluntary disclosure, the prudent insurer mere influence test of materiality and the all-or-nothing remedy for breach of disclosure have been adopted, but they have been heavily criticised over the years for harshness to consumers. In practice, the English law relating to non-disclosure and misrepresentation has not been applied strictly in many instances where the insured is an individual consumer. This is because the Statements of Insurance Practice of the Association of British Insurers (ABI)[2] and the rulings of the Insurance Ombudsman Bureau (IOB)[3] play an important role in this area, which more or less mitigates the harshness of the law and give consumers a better deal than the strict law would allow.[4] In Australia, the ICA 1984 adopts the reasonable person

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[1] Such as ss. 17-20 of the MIA 1906 (UK); art.16 of the Insurance Law 1995 (PRC); and part II (ss.12-15) and part IV (ss.21-33) of the Australian ICA 1984.

[2] See *supra* Chapter One "Introduction" for the explanation of ABI.

[3] *Ibid.*

[4] There still appears to be a need for law reform in order to protect those commercial insureds and those who place their insurance with insurers other than the members of the ABI and/or the IOB. Recently British law reformers have recommended that Australian approaches relating to the utmost good faith, non-disclosure and misrepresentation, particularly to the test of materiality, should be used as a model in reforming English law. See J. Birds, Insurance Law Reform - the Consumer Case for a Review of Insurance Law. Published by the British National Consumer Council, 1997.

test of materiality. The Australian ICA 1984 seems to mitigate the common law position relating to the doctrine of non-disclosure and misrepresentation in both the test of materiality and the remedy for the breach of the duty. In China, the prudent insurer decisive influence test is adopted in the Insurance Law although it has not yet been completely determined. The Insurance Law also introduces the rule of causation to the remedy for the breach of utmost good faith.

However, it has been noted that, in China, the doctrine of disclosure is academically divided into voluntary disclosure and inquiry disclosure by some scholars.[5] The former has exactly the same meaning as the principle of utmost good faith as defined in English and Australian insurance law which refers to voluntary disclosure. Likewise, inquiry disclosure created by Chinese scholars is similar to the English concept of representation, *i.e.* asking and answering the questions on the proposal form. In China, there is no requirement for voluntary disclosure in non-marine insurance. By virtue of article 16 of the Insurance Law, the proposer's duty of good faith is to truthfully answer the questions raised by the insurer in the proposal form and the proposer's duty is released by answering the questions,[6] while in the Maritime Code 1992 (PRC), the duty of the good faith has exactly the same meaning as described in the MIA 1906 (UK), *i.e.* the insured must disclose to the insurer, before the contract is concluded, every material circumstance which is known to the insured: namely, in addition to answering the questions raised in the proposal form, the proposer is also required to disclose everything which is material to the insurer for the conclusion of the contract.

By virtue of English and Australian laws, the doctrines of non-disclosure and misrepresentation are quite different. The rule relating to the misrepresentation has been, in the main, developed by the courts of equity, whilst non-disclosure is decidedly a creature of common law.[7] However, in practice, rules relating to misrepresentation and non-disclosure, at least as they affect materiality and subsequent avoidance, have always been the same.[8] Cases have frequently failed to distinguish between the two

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[5] Ding Yunzhou, Zhongguo Baoxianfa Jianming Jiaocheng (The Course on Chinese Insurance Law), p. 37, China Banking Press, 1995.
[6] See art. 16 of the Insurance Law.
[7] See J. Birds, *Misrepresentation and Non-disclosure in Insurance Law – Identical Twins or Separate Issue?* (1996) 59 M.L.R. p.285.
[8] See Lord Mustill's dictum in *Pan Atlantic Co Ltd and Another v. Pine Top Insurance Co Ltd.* [1994] 3

defences taken by an insurer and indeed it appears to be standard practice for an insurer, where possible, to plead both defences.[9] In this chapter, it does not really matter whether it is non-disclosure or misrepresentation, this chapter concerns what approach relating to the rules of the non-disclosure and misrepresentation is fairer to both insured and insurer.

In this chapter, the primary purpose is, in the first instance, to find out whether or not Chinese statutory laws in relation to non-disclosure and misrepresentation are fair to both parties and suitable to the Chinese situation, and what complementary rules are badly needed for implementing the principle of utmost good faith in China, and then to take the English law and the Australian law as reference and make suggestions to improve Chinese law in this respect. Particular focus is put on five aspects: firstly, to examine the test of materiality of the English approach and the Australian view in an attempt to determine a Chinese test of materiality of non-disclosure and misrepresentation; secondly, to attempt to find a better remedy for the breach of the duty of utmost good faith by comparing the three countries solutions; thirdly, to analyse the relationship between the basis of the contract clause and the test of materiality of the non-disclosure and misrepresentation; fourthly, to discuss the gaps between law and practice relating to utmost good faith in China; and finally, some suggestions or recommendations are made for the amendment of the Insurance Law and for the establishment of complementary rules and detailed regulations in respect to non-disclosure and misrepresentation.

2. The Origin and the Rationale of the Principle of the Utmost Good Faith

The origin of the principle of utmost good faith and the duty of disclosure, it is said, is ancient Roman law.[10] It developed in the context of insurance in Italian City States in the 14th and 15th Centuries.[11] The introduction of this doctrine to the insurance

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All E.R. 581, at 588-619. See also J. Birds, *Misrepresentation and Non-disclosure in Insurance Law – Identical Twins or Separate Issues?* (1996) 59 M.L.R. pp. 285-296.

[9] See R.A. Hasson (1975) 38 M.L.R. p.89.

[10] See Robert J Davis, *The Origin of the Duty of Disclosure under Insurance Law,* [1991] vol. 4, I.L.J. pp. 71-82.

[11] *Ibid.*

context of England clearly reflects the domination and influence of marine insurance in the development of the general law of insurance in England.[12] In early times, in Lloyd's coffee house, when a shipowner or a merchant wished to take out insurance for his ships, cargoes or a particular adventure, he would pass a 'slip' with details of the risk etc. to each relevant underwriter in turn. All the underwriters who were willing to insure the said risk would then initial the 'slip' and write down the percentage of the risk which they were willing to insure. It was not uncommon that when the 'slip' was being passed around, the insured ship or cargo had already started its voyage and was on the high seas. In the absence of the sophisticated means of communication which are available to modern day underwriters, it was certainly then beyond the means of the individual underwriters to verify the truth or accuracy of the information given in the 'slip'. The 'slip', which contained a brief description of the subject matter of the insurance, was the sole yardstick by which the underwriter could assess the risk of a particular adventure and decide whether to accept the risk or what the premium rate was. As the underwriter knew nothing and the proposer knew everything, thus it was necessary for the proposer to be honest and to describe the subject matter of the insurance and the adventure truthfully. Honesty and trust between the parties was thus absolutely necessary for the survival of the insurance industry.

What started as a rule of practice in marine insurance soon matured into a principle of law, not only in marine insurance but also in non-marine insurance. In the well-known leading case *Carter v. Boehm*,[13] the general principles upon which the duty of disclosure is based were stated by Lord Mansfield. The doctrine of non-disclosure was recognised for the first time by common law, and the duty of disclosure in insurance contracts was established in the form of law in England. This case concerned a policy against the capture of Fort Marlborough on Sumatra by a European enemy. Following the attack on the fort by the French, the insured claimed under the policy, but the insurer declined the claim on the grounds that the insured did not disclose the fact that the fort had not been designed to withstand attack from people other than the natives of Sumatra, and that the French were known to have designs on the fort. The Court of King's Bench held that these facts did not have to be disclosed as the underwriter should have himself known them, but the judgement of Lord Mansfield contained the

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[12] *Ibid.*

classic statement of the relevant principles: "Insurance is a contract upon speculation. The special facts, upon which the contingent chance is to be computed, lie more commonly in the knowledge of the insured only: the underwriter trusts to his representation, and proceeds upon the confidence that he does not keep back any circumstance in his knowledge, to mislead the underwriter into a belief that the circumstance does not exist, and to induce him to estimate the risqué as if it did not exist. The keeping back of such circumstances is a fraud, and therefore the policy is void. Although the suppression should happen through mistake, without fraudulent intention; yet still the underwriter is deceived, and the policy is void; because the risque run is really different from the risque understood and intended to be run at the time of the agreement."

The principle of utmost good faith applied not only to the proposer or the potential insured but also to the insurer who knew the facts relevant to a particular risk. The existence of this so-called reciprocal duty of disclosure on the part of the insurer was also recognised by Lord Mansfield in *Carter v Boehm*.[14] "The policy would be equally void, against the underwriter, if he concealed, as if he insured a ship on a voyage, which he privately knew to be arrived, and an action would lie to recover the premium."

The principle of utmost good faith was codified in MIA 1906 (U.K.). The subjects of disclosure and representations are dealt with in sections 17 to 20 of this Act. The principles set out in sections.17 to 20 are now recognised as being of general application, both in marine and non-marine insurance.[15] In section 17, it is said: "A contract of marine insurance is a contract based on the utmost good faith, and if utmost good faith be not observed by either party, the contract may be avoided by the other party." This section reaffirmed that the contract of insurance is the primary illustration of a class of contracts described as *uberrimae fidei,* that is the utmost good faith which was established by Lord Mansfield in the leading case of *Carter v Boehm*.[16] Under this principle, the parties to a contract are bound to volunteer to each other all material

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[13] (1766) 3 Burr 1905; 97 E.R. 1162.
[14] *Ibid.*
[15] C.B. Jonathan, Arnould Law of Marine Insurance and Average, vol. III, (16th ed.), p.304, para. 579AA, London Sweet & Maxwell, 1997.
[16] (1776) 3 Burr 1905; 97 ER 1162.

facts which they privately know. The obligation is binding upon both parties, and either party is entitled by the law to void the contract where the other party breaches the duty.

The three following sections (sections 18-20) deal in more detail with the duties imposed on the assured. It stresses the insured's duty of disclosure in section 18 and stipulates: "Subject to the provisions of this section, the insured must disclose to the insurer, before the contract is concluded, every material circumstance which is known to the assured, and the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him. If the assured fails to make such disclosure, the insurer may avoid the contract." The statute requires the insured to disclose every information he knows or ought to be known in the ordinary course of business. The underlying basis for the insured's duty of disclosure was the dictum of Lord Mansfield in the case of *Carter v Boehm* that "... The special facts, upon which the contingent chance is to be computed, lie more commonly in the knowledge of the insured only....." and the facts that in almost every instance in which a policy of marine insurance is effected, the underwriter must rely solely on the good faith of the insured for supplying him with full and true information of many of those facts on which the character and nature of the risk, and consequently the rate of premium, depend. Section 18(1) also stipulates that the disclosure must be done "before the contract is concluded", it deduces that the doctrine apply only to a pre-contractual situation. The time of disclosure will be considered in detail later in this chapter.

In section 18(2), the test for materiality was established by law. It is provided: "Every circumstance is material which would influence the judgement of a prudent insurer in fixing the premium, or determining whether he will take the risk." The test of materiality will be fully discussed later under the title of "the test of materiality", which is the main point at issue in this chapter.

The rule of representation was stipulated in section 20. Like the duty of disclosure, the rules relating to representation made by an insured also stem from the principle of utmost good faith laid down in section 17.[17] The test of materiality and the legal

[17] Susan Hodges, Law of Marine Insurance, p.92, Cavendish Publishing Limited, 1996.

consequence of misrepresentation are the same as those of non-disclosure.[18] However, practically, misrepresentation in the strict sense has not been particularly important in the insurance context, mainly because the extreme width of the duty to disclose material fact has meant that non-disclosure has often subsumed questions of misrepresentation.[19]

The principle of utmost good faith is still applicable in modern insurance when advanced means of communication are provided. Although the insurer may verify the truth or accuracy of the information given by the proposer by advanced means of communication, it is practically impossible for him to investigates every risk or check every subject matter of insurance which the proposers are hoping to get cover for. The proposer or the potential insured, however, is deemed to know every thing about the condition of the subject matter and the degree of the risk, he is therefore expected to disclose the facts to the insurer which the insurer will rely on to decide whether or not he will provide the cover, and if so, what premium he will charge. So far as the duty of disclosure of the insurer is concerned; on the one hand, the insurance terms and conditions are complicated and the types of cover are diversified and abundant which are made and understood by the insurer, while the proposer has poor knowledge of them, the insurer is therefore obliged to explain the terms to the proposer.[20] On the other hand, the insurer may sometime privately know relevant information related to the insurance contract, and is therefore required to disclose to the proposer every important fact relating to the insurance which he knows but the insured does not.[21]

3. The Laws Relating to Non-disclosure and Misrepresentation in the PRC

In China, the principle of good faith applies to all civil activities and all contracts. In

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[18] In s.20(1), it is said: "Every material representation made by the assured or his agent to the insurer during the negotiations for the contract, and before the contract is concluded, must be true. If it be untrue the insurer may avoid the contract. And in s.20(2), it is said: "A representation is material which would influence the judgement of a prudent insurer in fixing the premium, or determining whether he will take the risk."

[19] J. Birds, Modern Insurance Law, (4th ed.), p.99, 1997.

[20] Art. 16 of the Insurance Law (PRC).

[21] As Lord Mansfield said in *Carter v Boehm:* "The policy would be equally void, against the underwriter, if he concealed, as if he insured a ship on a voyage, which he privately knew to be arrived, and an action would lie to recover the premium." This dictum is still applied in modern insurance.

the Civil Law 1986, it is provided: "Civil activities must be carried out in accordance with the principles of voluntariness, fairness, exchange of equivalent values, honesty and good faith." The Contract Law 1999[22] has a similar provision. This principle is embodied in all contracts including the contract of insurance. Article 4 of the Insurance Law provides; "Parties engaged in insurance activities must abide by the laws and administrative regulations and adhere to the principles of voluntariness, honesty and good faith." In addition to the general principle of good faith, the Insurance Law also introduces the doctrines of disclosure and representation which are regarded as "utmost" good faith particularly apply to insurance contracts.[23] The requirement of extended good faith, it is submitted, is based on the special feature of the insurance contract by which the risk is transferred from one party to another, and on the other feature that the insured knows his subject matter of the insurance better than the insurer.

It is therefore submitted that the doctrines of non-disclosure and misrepresentation adopted in the Insurance Law combine both the principle of good faith in civil law and the utmost good faith defined in English law.[24] In China, the prevailing insurance law relating to the utmost good faith is the Insurance Law. This principle was, as early as 1983, adopted in the Regulations on Contracts of Property Insurance 1983 (PRC). In article 7, it is stated: "At the time a contract of insurance is concluded, the insurer shall advise the proposer of all matters related to the way of effecting insurance, and the proposer shall, as required by the insurer, disclose all material circumstances of the risk which the insurer needs to know in deciding whether or not to accept the risk or on fixing premium." It also stipulated the remedy: "Should it be discovered after the conclusion of the contract of insurance that there is any non-disclosure, concealment or misrepresentation by the proposer of the material circumstance of the risk mentioned in the proceeding paragraph, the insurer shall be entitled to rescind the contract of insurance or disclaim liability." From this article, it is clear that the duty of disclosure is imposed on both the proposer and the insurer, but the emphasis is put on the proposer. It is understood that the words "as required by the insurer" refer to "the

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[22] The Contract Law of the PRC was enacted by the 2nd Session of 9th NPC in 1999.

[23] See arts. 16 and 17 of the Insurance Law. Although the exact words of "utmost good faith" can not be found in the Insurance Law, the meaning of this principle is embodied in arts. 16 and 17.

[24] As has been mentioned earlier, the practice of insurance was introduced from England to China, so was the principle of the utmost good faith.

questions inquired by the insurer in the proposal form", it means that the proposer is required to truthfully answer the questions in the form. The law gives the insurer the right to rescind the contract of insurance or refuse liability where the proposer breaches his duty of disclosure or makes false representation.

On the basis of the provisions in relation to disclosure and representation stipulated in article 7 of the 1983 Regulation, the Insurance Law 1995 deals in more detail with the duties of disclosure and representation imposed on the parties. In article 16(1), it is stated: "When concluding an insurance contract, an insurer shall explain the details of the terms and conditions of such a contract to the proposer and may raise questions concerning relevant details of the insured subject matter, or of the insured. The proposer shall truthfully disclose such details to the insurer." This article indicates that the duty applies to both the insurer and the proposer and applies during the negotiation of the conclusion of the contract.

In article 16(2) it is stated: "The insurer shall have the right to rescind the insurance contract where the proposer withholds facts at ill will[25] and fails to perform his duty of disclosure and truthful representation of information to the insurer or fails to perform such duty as a result of a mistake so that the failure of disclosure or representation shall sufficiently influence the insurer's decision on whether or not he will accept the insurance or raise the premium rate." This article provides an objective standard of examining what facts are material facts, upon which the Chinese test of materiality may be determined.

In article 16 (3) and (4), the consequences of a breach of this duty by a proposer are stipulated. It is provided in article 16 (3): "Where the proposer fails to perform his duty of disclosure and truthful representation of information to the insurer at ill will, the insurer shall not be liable for payment of insurance moneys in connection with events insured against that occur prior to the rescission of the contract, and shall not refund the premium." In article 16 (4) it states "Where the failure of the proposer to

[25] The term "at ill will" means intentionally or deliberately, this is a translation error. In other English version of this law, the word "intentionally" was used instead of "at ill will". See the translation of the Insurance Law 1995 of the PRC by the Legislative Affairs Commission of the Standing Committee of the NPC, Science Press, Beijing, China.

perform his duty of disclosure and truthful representation as a result of a mistake has a serious impact on the occurrence of events insured against, the insurer shall not be liable for payment of insurance moneys in connection with events insured against that occur prior to the rescission of the contract, but he may refund the premium."[26]

Article 16 (3) and (4) of the Insurance Law have modified the 1983 Regulation in respect of the disclosure and representation by imposing different consequences for a breach of the duty deliberately or caused by negligence. The 1983 Regulation did not distinguish the consequences between a breach of the duty by the proposer *deliberately* and that caused by *negligence*. Under article 7(2) of 1983 Regulation, the insurer is entitled to rescind the contract or disclaim liability no matter whether a failure of disclosure is caused by the proposer *intentionally or negligently*, while article 16(4) of the Insurance Law restricts, by introducing the doctrine of causation, the ability of an insurer simply to disclaim liability. It provides that where the proposer fails to perform his duty *negligently*, the insurer may refuse liability only when the undisclosed or misrepresented fact has a *serious impact* on the occurrence of the events insured against. In other words where the loss has a causative relation with the non-disclosed information, the insurer is not liable. It implies that, if the occurrence of the events insured against has a *light impact* on or no causative relation with the undisclosed or misrepresented fact, the insurer should be liable.[27] This modification is in favour of the insured. This will be discussed later under the caption of "The effect of the non-disclosure".

The Insurance Law also reflects the reciprocal character of the principle of the utmost good faith. Both the proposer and the insurer have the duty of disclosure of material facts related to the contract of insurance. In articles 16 and 17, the law requires the insurer to explain to the proposer the details of the terms and conditions of the contract, in particular those which concern exceptions of the insurer's liability.

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[26] One thing in this article needs to be discussed here. The Insurance Law uses the words that "the insurer *may* refund the premium to the proposer" may cause confusion, because it is easy to understand that the insurer *may* or *may not* refund the premium. What is the intention of the drafter is not clear. It is suggested that the word *may* could be replaced by *should*. If the insurer refuses liability, he has, in fact, not been at risk, so he should refund the premium to the proposer unless the later deliberately conceals material information. (emphasis added).

[27] Art. 16(4) embodies the rule of causation, *i.e.* if the occurrence of an event caused or seriously

Matters of non-disclosure and misrepresentation in marine insurance are governed by the Maritime Code 1992. In article 222, the law stipulates what information the proposer or insured should disclose and when he should do so. It is stated: "Before the contract is concluded, the insured shall truthfully inform the insurer of the material circumstances which the insured has knowledge of or ought to have knowledge of in his ordinary business practice and which would influence the insurer[28] in deciding the premium or determining whether he agrees to insure or not." It must be noted that this article is essentially different from article 16 of the Insurance Law in two aspects: (1) The scope of information that the proposer is required to disclose to the insurer is different. Article 16 of the Insurance Law requires the proposer to disclose and represent the material facts within the scope of the questions raised in the proposal form, while article 222 of the Maritime Code requires the proposer to disclose and state the material facts which he knows or ought to be aware of in his ordinary business practice. It is clear that the latter is broader in scope than the former in respect of the duty of utmost good faith. By the latter the proposer is obliged to disclose a material fact which is outside the questions raised in the proposal form, but it is not necessary for him to disclose it under the former. (2) The test of materiality is different. Article 222 of the Maritime Code uses the words *influence the insurer's decision* leaving the word *influence* unadorned, while article 16 of the Insurance Law adds a word *sufficiently* before the word *influence*, namely, under article 16, a fact is material only if it would sufficiently influence the insurer's decision on whether he will accept the risk or what premium he will charge. It is obvious that the degree of the *influence* is different between the two articles under the unadorned *influence* and the *sufficiently influence*. By virtue of *sufficiently influence*, a non-disclosed fact is material only if it decisively influences the insurer's decision on whether he agrees to accept the risk and what is the premium rate. In other words, a fact is material where the insurer would have declined the risk altogether or charged a higher premium if the fact had been disclosed. However the word *influence* causes different interpretations in England.[29]

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impacted by an undisclosed fact, the insurer has right to refuse liability, otherwise, he may not.

[28] It should be noted that in some translation works the words "would influence the insurer" were translated to be "have a bearing on the insurer". It is submitted that the meaning of the former translation is better to reflect the Chinese meaning which is adopted in this thesis.

[29] Art. 222 of the Maritime Code basically introduces s.18 (1) and (2) of the MIA 1906 (UK). The meaning of the words "would influence the judgement" employed in s.18 have been strongly argued in

Whatever the interpretations are, the meaning of *sufficiently influence* must be stronger than the mere *influence*.

Article 223 of the Maritime Code imposes remedies for the non-disclosure and misrepresentation by the proposer or insured. It provides: "Upon failure of the insured to truthfully inform the insurer of the material circumstances set forth in the first paragraph of article 222 of this Code due to his intentional act, the insurer has the right to terminate the contract without refunding the premium. The insurer shall not be liable for any loss arising from the perils insured against before the contract is terminated. If, not due to the insured's intentional act, the insured did not truthfully inform the insurer of the material circumstances set out in the first paragraph of article 222 of the Code, the insurer has the right to terminate the contract or to demand a corresponding increase in the premium. In case the contract is terminated by the insurer, the insurer shall be liable for the loss arising from the perils insured against which occurred prior to the termination of the contract, except where the material circumstances uninformed or wrongly informed have an impact on the occurrence of such peril." It is noted that the remedies for a breach of the duty are similar between the Insurance Law and the Maritime Code, it is therefore not necessary to discuss them separately.

4. The Test of Materiality

How to determine whether or not an undisclosed or a misrepresented piece of information is material is a point in issue in England. Perhaps the most disputed issue in the realm of non-disclosure and misrepresentation is the test of materiality in England. However, in China, there is no issue being raised on this point. This does not mean that the problems on test of materiality have been solved in China, but that its importance has not been recognised, so no published papers or articles on this question have been found. In judicial practice in China, there are only a few reported cases relating to non-disclosure and misrepresentation. Most of them relate to the facts that the non-disclosed facts are obviously such facts that the insurer would have declined

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England in recent years, see the case of *Container Transport International Inc v. Oceanus Mutual*

the insurance altogether or charged a higher premium had he known them. It is therefore not difficult for the insurer to refuse liability or for the court to judge for the insurer. So there are few arguments on the test of materiality in judicial practice. The test of materiality has yet to be determined in China. The purpose at this stage is to take the English test and the Australian test of materiality as a reference, and to analyse Chinese Insurance Law in respect of the doctrines of non-disclosure and misrepresentation so as to determine the test of materiality in China.

4.1 Article 16 of the Insurance Law

Article 16 is the main provision in the Insurance Law which relates to the principle of the utmost good faith. It deals with the test of materiality and the remedy for non-disclosure and misrepresentation by the proposer. Article 16 indicates four aspects:

(1) The time when the proposer must perform his duty of good faith – during the negotiation of the contract of the insurance when the proposer fills up the proposal form.

(2) The persons who must perform this duty – the proposer and the insurer.

(3) What information is material which the proposer must disclose and represent truthfully – the facts which sufficiently influence the insurer's decision on whether he will accept the insurance or raise the premium rate.

(4) The effect for non-disclosure and misrepresentation – different effects are imposed on the proposer according to whether he breaches the duty fraudulently, negligently and innocently.

At this stage, emphasis is focused on the third aspect, *i.e.* what is material fact? namely what is the test of materiality? This question is dealt with in the second paragraph of article 16, it is stated: "The insurer shall have the right to rescind the insurance contract where the proposer withholds facts at ill will[30] and fails to perform his duty of disclosure and truthful representation of information to the insurer or fails to perform such duty as a result of a mistake so that the failure of disclosure or representation shall sufficiently influence the insurer's decision on whether or not he will accept the insurance or raise the premium rate." By virtue of this paragraph, a material fact is a

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Underwriting Association [1984] 2 Lloyd's Rep 178 which will be fully discussed shortly.

fact which shall *sufficiently* influence the insurer to make his decision on *whether he will accept the insurance* or *raise the premium rate*.[31] It means that before the insurer can avoid the contract, he must prove that he would have made a different decision or raised the premium rate if he had known the fact concealed or misrepresented by the proposer. For example, a Chinese life insurance case illustrates this point.[32] A proposer effected a life policy on her mother's life, the insured amount was RMB 240,000. In the proposal form, questions asked were (a) whether the life insured had stayed in hospital or had any operations within the last 10 years; (b) whether the life insured had suffered from any serious disease, such as high blood pressure, heart disease and so on (the form listed 14 kinds of diseases); for both questions and all the 14 kinds of diseases, the answers are "negative". When the life insured died, the proposer raised a claim under the policy. The claim was rejected by the insurer on the ground that the proposer concealed the facts that the life insured had suffered several diseases listed in the proposal form, and the insurer would have refused to accept the application for the cover if these facts had been disclosed. The court made judgement for the insurer.[33]

However, the test of materiality of non-disclosure and misrepresentation has not been determined although article 16 produces a brief definition of what is a material fact. Some ambiguities can be found in this article, such as does the "insurer" mentioned in this article refers to a prudent insurer or an actual insurer, and what does the phrase "sufficiently influence" exactly mean? Before clarifying these ambiguities, it is necessary to examine the test of materiality of non-disclosure and misrepresentation in England and Australia in order to determine the test of materiality in China.

4.2 The test of materiality in England

In England, the common law test for materiality is codified in section 18(2) of the MIA1906 which provides that: "Every circumstance is material which would influence the judgement of a prudent insurer in fixing the premium or determining whether he

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[30] See note 25 *supra*.
[31] Emphasis added.
[32] See Zhongguo Baoxian Bao (Chinese Insurance News), p. 1, No.517, June 1999.
[33] A similar case was reported in the Chinese Insurance News, p. 1, No. 526, July 1999.

will take the risk." Although the test is contained in legislation applicable by its terms only to marine insurance, it is clear from the authorities that the same test applies equally to non-marine insurance. In *Lambert v. Co-operative Insurance Society*,[34] a non-marine insurance case, the Court of Appeal held that its statutory formulation in these terms in section 18 of the MIA 1906 was a codification of the common law applicable to all insurance contracts. This dictum was also illustrated in *Joel v. Law Union Insurance Co.*,[35] and a recent case of *Pan Atlantic Insurance Co Ltd v. Pine Top Insurance Co Ltd.*[36]

The brief definition for a material fact formulated in section 18(2) has caused drastic argument. It is clear that this sub-section contains four phrases, namely (1) would influence the judgement; (2) the prudent insurer; [37] (3) fix the premium; (4) determine whether the insurer will take the risk. It seems that no disputes have been caused by (2), (3) and (4).[38] The pivotal issue is focused on the phrase of "would influence the judgement" of the prudent insurer. Section 18(2) is ambiguous in dealing with the question of the degree to which a prudent insurer would have been influenced in his conduct had he been in possession of the relevant facts. For the phrase of "would influence the judgement", at present, there are at least two different interpretations, namely, the "decisive influence" test and the "mere influence" test:[39]

(1) The "decisive influence" test. Under this it is necessary for the insurer to satisfy the court when he declines a claim on the ground of non-disclosure by the proposer that a prudent insurer would have acted differently as regards the premium or risk had the information withheld or misstated been made available to him.

(2) The "mere influence" test. Whereby it is sufficient for the insurer to demonstrate that a prudent insurer would have wished to know the information in question when making his decision, and would not necessarily have acted any differently as regards the premium or the risk.

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[34] [1975] 2 Lloyd's Rep. 485.
[35] [1908] 2 K.B. 863.
[36] [1994] 3 All E.R. 581.
[37] The meaning of the term "prudent insurer" was considered by Atkin, J. in *Associated Oil Carriers, Ltd. v Union Insurance Society of Canton, Ltd.* [1917] 2 K.B. 184. In some case, however, the term adopted has been that of a "reasonable" insurer. The words "reasonable" and "prudent" are interchangeable.
[38] For the phrases listed in (2), (3) and (4), there are clear explanations in Professor Merkin's work, Insurance Contract Law, p.A.5.3 –01 to A.5.3-02.
[39] See *Container Transport International Ltd. v. Oceanus Mutual Underwriting Association* [1984] 1 Lloyd's Rep. 476.

Although the phrase of "would influence the judgement" appears at the beginning of the 20th century in the MIA 1906 (which, to a large extent, codified the earlier case law), the two interpretations for the phrase had not been seriously discussed until 1982, in the case of *Container Transport International Inc. v. Oceanus Mutual Underwriting Association (Bermuda) Ltd.*[40] which discussed at some length the test of materiality as laid down in the MIA. In that case, Lloyd J opted firmly for the "decisive influence" test in determining whether the insured had made truthful representation and disclosure of the material facts to the insurer, and he stated: "underwriters ought only to succeed on a defence of non-disclosure if they can satisfy the court by evidence or otherwise that a prudent insurer, if he had known the fact in question, would have declined the risk altogether or charged a higher premium... it can never be enough for the prudent insurer to say 'yes, I would have liked to know this or that fact, so that I could have made up my mind

what to do about it.'" However, Lloyd J's formulation was rejected by the Court of Appeal on appeal in the *CTI* case. Kerr L.J. said:[41] "The word 'judgement' - to quote the Oxford English Dictionary to which we were referred - is used in the sense of 'the formation of an opinion'. To prove materiality of an undisclosed circumstance, the insurer must satisfy the court on a balance of probability - by evidence or from the nature of the undisclosed circumstance itself - that the judgement, in this case, of a prudent insurer would have been influenced if the circumstance in question had been disclosed. The word 'influenced' means that the disclosure is one, which would have had an impact on the formation of his opinion and on his decision-making process." This approach appears to adopt the broad test, *i.e.* the "mere influence" test. The test in *CTI* has thus received heavy criticism from practitioners, arbitrators and academics alike due to its apparent harshness.[42] Indeed, it is really not easy for any insured to discern what would affect the reasonable insurer's mind. The insured would have to possess extraordinary powers of perception for him to be able to distinguish which

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[40] [1984] 1 Lloyd's Rep. 476.

[41] [1984] 1 Lloyd's Rep 476, at page. 492.

[42] See Brooke, *Materiality in Insurance Contracts* [1985] L.M.C.L.Q. 437; Khan, *A New Test of Materiality Insurance Law* [1986] J.B.L. 37; Clarke, *Failure to Disclose and Failure to Legislate: Is it Material?* [1988] J.B.L. 298; and Yeo Hwee Ying, *Common Law Materiality - an Australian Alternative* [1990] J.B.L. See also N.J. Hird, *Rationality in the House of Lords* [1995] J.B.L. 194. In that article, Hird comments: "...How can anything be said to influence someone's judgement if, at the end of the day, it actually did not."

facts a prudent insurer would consider to be material. The *CTI* rule of materiality therefore operates rather unfairly against lay individuals.

Although the *CTI* decision has drawn much flak from various quarters, the House of Lords in a recent case of *Pan Atlantic Co. v. Pine Top Insurance Co. Ltd.*[43] followed the *CTI* decision by a bare majority of 3 to 2 when determining the test of materiality. However, the House of Lords did not ignore the harshness of the *CTI* ruling, in *Pan Atlantic* case, it produced a novel additional requirement into the rules of non-disclosure and misrepresentation, *i.e.* the inducement requirement, namely, before avoiding the contract, the insurer in question must show that the fact of non-disclosure or misrepresentation has induced him to enter into the contract, in addition to satisfying the prudent insurer test. "Induced" in this sense is given the same meaning as it is under the general law of contract.[44] This requirement clearly mitigated the rigour of the *CTI* decision. The introduction of the inducement, however, as Atiyah has stated: "This decision, to some extent, takes away with one hand what it gives (to insurers) with the other, because in cases where it is held that non-disclosure was barely material, the court may well now go on to hold that it did not have any causal effect."[45]

A more recent case of *St Paul Fire and Marine Co (UK) Ltd v. Mcdonnell Dowell Constructors Ltd.*[46] was determined to follow the *Pan Atlantic.* Moreover, *St Paul* resolved the unclear question left by *Pan Atlantic* of the force of inducement requirement. In this respect, it was held in *St Paul* that it is not necessary to demonstrate that the non-disclosure was *the sole* inducement. It is sufficient that it is *an* inducement. In the absence of evidence from the underwriter concerned the very nature of the undisclosed fact may create a factual presumption in favour of finding inducement.[47] Thus the view of "presumption of inducement" was introduced in *St Paul*, but the limitation for the presumption of the inducement was imposed. In

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[43] [1994] 2 Lloyd's Rep. 427.
[44] See Lord Mustill in *Pan Atlantic v. Pine Top* [1994] 2 Lloyd's Rep. 427, at 452.
[45] See Atiyah, An Introduction to the Law of Contract, p.259, 1995. See also J. Birds *Misrepresentation and Non-disclosure in Insurance Law – Identical Twins or Separate Issues?* (1996) 59 M.L.R. p.285, at 298. He comments: "The introduction of an inducement requirement has served only to muddy the waters, rather than clear them, which is what the House of Lords purportedly set out to do. There must now be a very strong argument for referring this whole issue back to the House for clarification and resolution."
[46] *St Paul Fire & Marine Ins. Co. v. McConnell Dowell Constructors* [1995] 2 Lloyd's Rep. 116.
[47] *Ibid.*, at 127.

relation to this question, Evans L.J. cited the following passage from Halsbury: "Inducement cannot be inferred in law from proved materiality, although there may be cases where the materiality is so obvious as to justify an inference of fact that the representee was actually induced, but, even in such exceptional cases, the inference is only a *prima facie* one, and may be rebutted by counter evidence."[48] Thus there is no simple presumption that because a matter is material, it is also an inducement.

A very recent case of *Marc Rich & Co., A.G. And Another v. Portman and Others*[49] followed the *Pan Atlantic* and *St Paul Fire* approach and introduced the doctrine of inducement too. The simple presumption of inducement was also refuted in this case. It was held that the presumption of inducement can only operate where the actual underwriter cannot (for good reason) be called to give evidence that he was actually induced to make the insurance contract and where there is no reason to suppose that the actual underwriter acted imprudently or negligently in writing the risk.[50]

Having examined the cases *Pan Atlantic*, *St Paul* and *Marc Rich*, it may be useful to provide a compendium of the law as it currently endures in England. The duty of disclosure is now composed of a two limb test:

(a) There is a right to avoid a contract of insurance only when an undisclosed fact is "material". A material circumstance is one that would be taken into account by a prudent underwriter when assessing his risk;

(b) Before a particular underwriter can avoid a contract for non-disclosure of a material fact, it must be shown that he or she had actually been induced by the non-disclosure to enter into the policy on the relevant terms. Moreover, there is no simple presumption that because a fact is material it is also an inducement.[51]

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[48] Halsbury's Laws of England [1983] vol. 31 at para.1067.

[49] [1996] 1 Lloyd's Rep. 430; upheld on appeal [1997] 1 Lloyd's Rep. 225.

[50] *Marc Rich & A.G. v. Portman* [1996] 1 Lloyd's Rep. 430. Here Longmore J. held: In most cases in which the actual underwriter is called to give evidence and is cross-examined, the Court will be able to make up its own mind on the question of inducement. The presumption will only come into play in those cases in which the underwriter cannot (for good reason) be called to give evidence and there is no reason to suppose that the actual underwriter acted other than prudently in writing the risk. In cases where he is called and the Court genuinely cannot make up its mind on the question of inducement, the insurer's defence of non-disclosure should fail because he will not have been able to show that he had been induced by the non-disclosure to enter into the insurance on the relevant terms. At the end of the day it is for the insurer to prove that the non-disclosure did induce the writing of the risk on the terms in which it was written."

[51] See Shane Kilcommins, *The Duty of Disclosure Revisited: St Paul Fire and Marine v. McConnell Dowell Constructors*, The Juridical Review 1997, part 2. pp.125-132.

Another question may be raised from the two-limb test, *i.e.* what is the relationship of the prudent insurer test of materiality and the inducement requirement for the actual insurer? These cases mentioned above left the question unclear as to how the requirements are to operate together. In *Pan Atlantic*, Lord Mustill put forward a view of "presumption of inducement" to the effect that once the insurer has satisfied the court that a prudent insurer would have been influenced by the fact misrepresented or withheld, it may be assumed that the insurer was in fact so induced and observing that the insured would face "an uphill struggle" to disprove inducement once the insurer had established materiality.[52] However, Lord Lloyd is of the opinion that the notion of a presumption is a heresy long since exploded.[53] He regards the two legal concepts as totally distinct, and takes as the starting point the actual inducement of the insurer. Only when actual inducement has been shown does the question of materiality arise. According to Lord Lloyds's view, as H. N. Bennett comments:[54] "the requirement of materiality today serves merely to prevent an idiosyncratic insurer availing himself of the remedy of rescission on the basis of non-disclosure of a circumstance which no prudent insurer would take into account and which no assured can therefore be expected to disclose without being asked. In consequence, a conclusion that a circumstance is in law material is very far from a conclusion that the insurer in question was decisively influenced into concluding the contract on the agreed terms."

It could be concluded that:

(1) Before an actual insurer is allowed to avoid a contract, he must satisfy the court that he has been induced to enter into the contract, and in addition to satisfy the test of materiality.

(2) Before an actual insurer is allowed to avoid a contract, he must show the evidence that is a material fact, and in addition to prove that he has been induced to enter into the contract.

(3) A qualified presumption of inducement may arise in exceptional circumstances, such as in *St. Paul case*.[55]

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[52] [1994] 3 All E.R. 581, at 619.
[53] *Ibid.* at 637.
[54] H.N. Bennett, *Utmost Good Faith, Materiality and Inducement,* (1996) 112 L.Q.R. p.409.
[55] For example, in *St. Paul Fire* only three of the four insurer plaintiffs gave evidence as to inducement, the fourth did not. The Learned Judge held it was not necessary to show that the non-disclosure was the

What is now required, as Mattick has suggested, is for the courts to produce a decision where the presumption fails, in order to make clear how effective the actual inducement test really is.[56]

It has long been recognised that the prudent insurer test is too strict to the consumer. Recently, there have been some attempts to protect private individuals from the severity of the remedy of avoidance for pre-contractual non-disclosure or misrepresentation through the application of the test of honesty to matters which can be categorised as being matters of knowledge, belief or expectation. This is illustrated by *Economides v. Commercial Assurance Co. PLC.* [57] In this case, the plaintiff, who was a Cypriot and came to England to study in 1985 when he was 15 years old, effected a households contents policy with the defendant in 1988, the insured sum was £12,000. His parents came to live with him later, and brought with them chattels including both jewellery and silverware. His father, who had been a divisional commander in the Cypriot police force, suggested an increase of approximately £3,000 should suffice. When the plaintiff renewed the policy in 1991, the insured sum was increased to £16,000 (including his parents' chattels). His flat was burgled 9 months later after the renewal. The replacement cost of those items was subsequently established at £30,970. The insurer denied liability on the grounds of misrepresentation. The Court of Appeal held that the insurer was liable. It is stated that when making an insurance contract, the insured is only under an obligation to be honest. The insured's belief, if made in good faith, was deemed to be honest, satisfying the subjective test in s.20(5) of the MIA 1906,[58] and a statement of belief by the insured that he honestly believed the accuracy of his valuation was not an implied representation that there were objectively reasonable grounds for the belief; that, further, when discharging his obligation to disclose all material facts known to him the insured was only required to be honest and to disclose what was within his actual knowledge, constructive knowledge being

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sole inducement, it was sufficient that it was *an* inducement (p.124), and that the necessary inducement of the three insurers was proved on the evidence. In addition, the fourth insurer was entitled to the benefit of a presumption of inducement on the basis of the obvious materiality of the non-disclosure [1995] 2 Lloyd's Rep. 116. at 127.

[56] Mattick, [1995] 8 Int. I.L.R. at 281.

[57] [1997] 3 W.L.R. 21.

[58] In s.20(5) of the MIA 1906, it is stated: "A representation as to a matter of expectation or belief is true if it be made in good faith."

irrelevant; and that, accordingly, since the plaintiff had satisfied the obligation of honesty, the defendants could not avoid liability on the grounds of misrepresentation and non-disclosure.

It is submitted that this decision does not apply to all the insureds but for the individual insured. In this case, both the plaintiff (he was just 21 when the policy was renewed) and his father were reasonable men, not jewellery businessmen, and not in the course of their business, so the statement on the insured value of the subject matter of insurance, although it was wrong, was held to be made honestly. However, if the insured were a jewellery businessman, and he were in the course of his business, the constructive knowledge would have been relevant, he would have been deemed to know the true value of the jewellery. The decision in this case largely mitigates the harshness of the prudent insurer test. In the view adopted by English law, the insured's duty on disclosure and representation would be defined that an untrue statement made by an insured person is not misrepresentation if he/she honestly believed it to be true, and is a misrepresentation in law only if the insured person knew, or a reasonable person in his position could be expected to have known, or a professional person, in the ordinary course of business, ought to have known that the statement would have been relevant to the insurer's decision. This is also the recommendation of the British National Consumer Council on law reform.[59] If the approach of "honesty" is adopted in England, the test of materiality would become unnecessary. Instead, the test of honesty needs to be established, because if it was held that a reasonable insured was merely under an obligation to be honest, it was irrelevant whether or not the undisclosed or misstated fact was material. The weakness of the judgements in this case seems to be that the judges failed to state exactly what grounds an insured must have had for believing something before it could be said that he acted honestly when representing his belief to an insurer. It has been suggested that an "objective reasonable ground" for the honesty of belief should be given by the insured.[60]

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[59] See J. Birds, Insurance Law Reform, The Consumer Case for a Review of Insurance Law, p.69, Published by the British National Consumer Council, 1997. This is also the Australian approach in respect of non-disclosure and misrepresentation which was stipulated in s.26 of the Australian ICA 1984. S..26(1) reads: "Where a statement that was made by a person in connection with a proposed contract of insurance was in fact untrue but was made on the basis of a belief that the person held, being a belief that a reasonable person in the circumstances would have held, the statement shall not be taken to be a misrepresentation."

[60] See Norma Hird, "*How to make a drama out of a crisis*", [1998] J.B.L. 279.

It should be noted that, in practice, the IOB Scheme and the ABI Statements of Insurance Practice have changed the insured's strict legal position as to non-disclosure and misrepresentation somewhat from what it was when the Law Commission made its recommendations for reform in the early 1980s.[61] However, the industry's Statements of Insurance Practice carry no legal force and do not apply to the minority of insurers that do not belong to the ABI or the IOB Scheme. Over the years, more and more complaints in relation to insurance come to the notice of the IOB, the citizen's advice bureaux and the Office of Fair Trading.[62] The National Consumer Council has recently drafted a report for insurance law reform, in which it is suggested that the only effective solution to some of the serious problems encountered by consumers (including the rules of non-disclosure and misrepresentation) when it comes to buying personal insurance is legislative reform, and it is recommended the Australian model of insurance law reform be followed in this area.

4.3 The Australian approach to the test of materiality

At this juncture, it is worthwhile to look at what the Australian approach is in respect to the test of materiality. In section 21(1) of the Australian ICA 1984, it is stipulated that "Subject to this Act, an insured has a duty to disclose to the insurer, before the relevant contract of insurance is entered into, every matter that is known to the insured, being a matter that:

(a) The insured knows to be a matter relevant to the decision of the insurer whether to accept the risk and, if so, on what terms; or

(b) A reasonable person in the circumstances could be expected to know to be a matter so relevant."

This section raises the question as to what test should be applied in terms of the "materiality" of the particular knowledge. There are at least three schools of thought on this matter: (1) The prudent insurer test still applies. (2) The court must refer to the concerns of the particular individual insurer. (3) The subjective test applies to section

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[61] See J. Bird, Insurance Law Reform, The Consumer Case for a Review of Insurance Law, p.67, published by the British National Consumer Council, 1997.
[62] *Ibid*, p.1.

21(1)(a) and the objective test should be used to determine the relevance of facts to the reasonable person of section 21(1)(b).[63]

Despite the different views on section 21(1), a number of commentators argue that the prudent insurer test is dead and buried in Australia.[64] The duty of disclosure is recast, in section 21 (1), as a duty to disclose facts which either the insured person knows to be relevant to the insurer's decision or which a reasonable person in the circumstances could be expected to know to be relevant. The focus of attention is thus moved from the prudent insurer of the common law to the actual knowledge of the insured or constructive knowledge of a reasonable person.

This test is a consumer oriented test, which to large extent mitigates the harshness of the common law prudent insurer test, but there are still some drawbacks as follows:
(a) By taking the reasonable person test, it must impose a standard which a great number of insureds would be unable to meet. This test makes the assumption that all insureds are equally capable of reaching the required standard. That is clearly impossible, because there are great differences among insureds in relation to education, culture, language and social and commercial experience which affect their abilities to comply with the standard of the reasonable person.
(b) Most consumers, through lack of experience or education or because of some other factors beyond their control, have less knowledge about insurance underwriting than could be expected of a "reasonable person". Such consumers are at risk of being accused of non-disclosure and having a claim denied, not because of a lack of honesty or candour but due to their lack of understanding of the nature of insurance.

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[63] The three schools of thought are supported separately by cases: (1) The prudent insurer test still applies. In the case of *Toikan International Insurance Broking Pty Ltd v Pasteel Windows Australian Pty Ltd.* (1989) 94 ALR 435, Samuels JA indicated that elements of the "prudent insurer" test remain as a gloss on the (then) new s.21; (2) The court must refer to the concerns of the particular individual insurer. This view was supported by the case *Lindsay v CIC Insurance Ltd.* (1989) 16 NSWLR 673; In this case the prudent insurer test was rejected by the Supreme Court of New South Wales. (3) The subjective test applies to s.21 (1)(a) and the objective test should be used to determine the relevance of facts to the reasonable person of s.21 (1)(b). A compromise has been suggested by Rolfe J in the case of *Thompson v Government Insurance Office* [1994] SC(NSW), p.14. These three schools of thought are summarised by Christine McCarthy in her article of *The "Prudent Insurer": the Test and its Impact of Section 21.* [1997] 8, I.L.J. p.136.
[64] Australian Torts Reporter (CCH Loose-leaf Service) 1996, p. 11,062; Per Mann and Candace Lewis, *Annotated Insurance Contracts Act*, pp.51-2; A. A. Tarr, *Australian Insurance Law*, 1987.

These questions have been recognised by the Australian Law Reform Commission[65] and the Australian Insurance Enquiries and Complaints Ltd.[66] So the General Insurance Enquires and Complaints Scheme of Australia suggested: "Compliance with the duty of disclosure should depend on a consumer's honesty and not his assumed knowledge of insurance practice. Insurers know what is relevant to their decision and are in a position to ask appropriate questions. As a matter of fairness, we believe that the statutory duty of disclosure should require only that the consumer give truthful answers to specific questions relevant to the risk for which cover is sought. It is noted that the General Insurance Code of Practice[67] deals with some of the issues raised above, and it is expected that this will reduce the difficulties attended. In particular the Code requires that documents should identify all usual information that the insurer ordinarily requires to be disclosed or represented and which the insurer wishes to know prior to providing cover."[68]

It is clear that the Australian law relating to the duty of disclosure described in s.21(1) of the ICA 1984 has somehow improved the consumer's position as to non-disclosure and misrepresentation, but it is still not very satisfactory due to the drawbacks as discussed above.

4.4 Determination of the Chinese test of materiality

With the general picture in mind of the English prudent insurer test and the Australian reasonable person approach, it is now appropriate to determine what the test of materiality of non-disclosure and misrepresentation is in China. As was considered above, article 16(2) of the Insurance Law indicates that a material fact is such a fact

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[65] See The Australian Law Reform Commission Report, *Insurance Contracts*, Report No 20, 1991, para 180.

[66] See the Australian Enquiries and Complains Ltd. 1995 Annual Report, 30 June 1995, p.4.

[67] The Insurance Council of Australia Limited has developed the General Insurance Code of Practice for use by all insurers. It is a self-regulating code to promote good relations between insurers, agents and consumers and good insurance practice by describing standards of good practice and service. It may be of interest to note that there are some differences between the Australian General Insurance Code of Practice (GICP) and The ABI Statement of General Insurance Practice (SGIP), although they are both self-regulatory and not legally binding. First, GICP is used for all insurers in Australian and it is a compulsory Code and sanction may be imposed upon insurers if they fail to meet the Code's requirements, while SGIP is used only by the members of ABI and it is not compulsory to the insurers. Secondly, SGIP is practised in a narrower way that it is only for private consumer business but not for commercial consumers, while GICP is practised in a wider way that it is for all insurance business.

[68] Insurance Enquiries and Complaints Ltd, Australia, 1995 Annual Report, 30 June 1995.

that shall sufficiently influence the insurer's decision on whether or not to accept the risk or what premium to be charged.[69] It means that an insurer ought only to succeed on a defence of non-disclosure or misrepresentation if he can satisfy the court by evidence or proof that, had he known the fact, he would have declined the risk altogether or charged a higher premium. In other words, where a fact concealed by the proposer at the time when the contract is concluded will affect the insurer's mind decisively for his assessment of the risk or fixing the premium rate, the insurer is entitled to avoid the contract. This is because the law used the words of "sufficiently influence" the "insurer's decision", not those such as "would influence the judgement" which were employed in section 18(2) of the MIA 1906 (UK). It is submitted that the words "sufficiently influence" are enough to establish the "decisive influence test".

The matter which was left unclear is whether the term "insurer" as referred to in this article denotes a "prudent insurer" or an "actual insurer". Because the terms of "prudent insurer" and "actual insurer" originated from English law,[70] the distinction between them has not been discerned in China. It is suggested that the term "insurer" mentioned in this article should denote a "prudent insurer" or "reasonable insurer". There are at least two reasons which may support this view: (1) according to article 9(3) of the Insurance Law, the term "insurer" refers to insurance companies that conclude insurance contracts with proposers and assume liabilities for payment of insurance moneys. Insurance companies can be regarded as prudent or reasonable insurers but not particular or actual insurers. (2) In China, the basic insurance clauses and premium rates for the main types of risk in commercial insurance are formulated by the Financial Supervision and Control Department of the State.[71] All insurance organisations use standard insurance clauses and standard premium rates, so there should be a united standard which is used to test whether a non-disclosed or misstated

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[69] Since the promulgation of the Insurance Law, there is no any annotation on this article by authorities, no detailed rules for complementing it and no reported cases by courts or arbitrators to be found. An essay has been noted in which the writer briefly interprets article 16, but it totally failed to discuss the test of materiality. See Li Lanruo, "*Baoxian Hetong Shuangfang Bixu Luxing Rushi Gaozhi Yiwu" (Parties of an Insurance Contract must perform the duty of disclosure*). In "Baoxianfa Shiying Quan Shu" (Applicable Book of Insurance Law), eds: editing group of this book, pp.276-278, China Procuratorial Press, 1996.

[70] The origins of the prudent insurer test are obscure. Objectivity was strongly rejected by Lord Mansfield in *Carter v Boehm* (1766) 3 Burr 1905. However, the prudent insurer test is clearly adopted in the MIA 1906, section 18 (2). See also Professor Merkin, Insurance Contract Law (loose-leaf), and vol. 1, p.A5.3-03, note 1.

[71] Art. 106 of the Insurance Law.

fact is material. It is therefore logically thought that the insurer mentioned in article 16 is a prudent insurer, and the test of materiality should take "the prudent or reasonable insurer" test, but not "the actual or particular insurer" test. It would not be the case that the court would adopt the opinion of any actual insurer to test a material fact of non-disclosure or misrepresentation. There must be evidence of other insurers.

Through the analysis of article 16, and with reference to English test of materiality and the Australian test of materiality, the test of materiality in China should now be determined as the "prudent insurer decisive influence test". However the application of this test must be within the scope of the questions asked by the actual insurer in his proposal form. Because, in China, the duty of utmost good faith will be performed by the proposer by truthfully answering the questions raised in the proposal form,[72] beyond those questions, no test can play a role.

In comparison with English insurance law and Australian insurance law in respect of the test of materiality of non-disclosure and misrepresentation, in China, it is submitted that the scope of the duty of disclosure is much narrower for the proposer. Because, first, it is sufficient for the proposer to answer honestly the questions asked by the insurer in the proposal form, and he will be relieved from the duty of disclosure by truthfully answering the questions. A failure to disclose a fact which is beyond the proposal form, however important it might be, does not give the insurer the right to avoid the contract or reject the liability on the ground of non-disclosure by the proposer. Secondly, not all information required by the insurer in the proposal form is material, but only that which is sufficient to influence the insurer's decision on whether or not he will accept the particular risk and what premium will be charged is considered as material.

Linked to the "prudent insurer decisive influence" test is the problem of the proof. Two pieces of evidence need to be shown before the actual insurer is allowed to avoid a contract or repudiate liability. If an insurer claims a fact misrepresented or withheld by a proposer has decisively influenced his decision, and he would not have accepted the risk, or would, at least, have demanded a higher premium had he known the true

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[72] This will be considered later in s. 7 of this Chapter "The duty of disclosure and answering the

fact, then he must show (1) the evidence of his previous decision in a similar case and the relevant terms of the contract; (2) other prudent insurers' evidences of their previous decisions and their understandings of the terms the actual insurer based on.[73]

4.5 Materiality in marine insurance – Article 222 of the Maritime Code (PRC)

Article 222 of the Maritime Code 1992 (PRC) provides: "Before the contract is concluded, the insured shall truthfully inform the insurer of the material circumstances which the insured has knowledge of or ought to have knowledge of in his ordinary business practice and which would influence the insurer in deciding the premium or whether be agreed to insure or not." This article regards a fact as material where it would influence the insurer's decision on fixing the premium or determining whether he would take the risk. As was mentioned earlier, according to article 222 of the Maritime Code and article 16 of the Insurance Law two different tests of materiality may be determined, one is for marine insurance and the other is for non-marine insurance. This is caused by the different degrees of the "influence" used in the two articles. As was discussed above, based on article 16 of the Insurance Law, a prudent insurer decisive influence test of materiality can be determined simply because the word "influence" is adorned by the word "sufficiently" which strengthens the degree of the "influence". It is suggested that the "sufficiently influence" and the unadorned "influence" present different thresholds of the test of materiality. Article 222 of the Maritime Code uses the unadorned "influence" which is submitted to present the lower threshold of the test, namely the "prudent insurer mere influence" test which was interpreted as meaning that a material circumstance is one which if disclosed would have had an impact upon the formation of a prudent underwriter's opinion and on his decision-making process. This was also the approach of the English courts in *Container Transport International Inc v. Oceanus Mutual Underwriting Association Ltd.*[74] by interpreting section 18 of the MIA 1906 (UK) which defines what a material fact is. The test of materiality, in England, is arguably accepted as "the prudent insurer

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questions in the proposal form".

[73] In China, the basic insurance clauses and premium rates for the main types of risk in commercial insurance shall be formulated by the Financial Supervision and Control Department (art. 106 of the Insurance Law 1995). Thus if the actual insurer can prove that he was decisively influenced by the undisclosed or misstated facts based on some terms of the policy and the prudent insurers have the same understanding for the terms, then the fact is material.

mere influence" test. In the absence of the judicial interpretation for article 222 of Maritime Code, the materiality described in that article should be interpreted as a broad test by following the English approach, because article 222 is, to a large extent, a copy of section 18 of the MIA 1906 (UK).

Consequently, in China, two tests of materiality would be established; one being "the prudent insurer decisive influence" test for non-marine insurance, and the other "the prudent insurer mere influence" test for marine insurance. Is it the purpose of the legislator or is it negligence? If it is the legislator's purpose, the only reason, it is thought, is that the marine insurance consumers are usually businessmen and they are in their course of business, and they are expected to understand what information would influence the insurer's mind when he is making his decision on whether or not to take the risk or on fixing the premium. Thus the law is harsher to the proposer in marine insurance than in non-marine insurance. There seems no good reason to treat the marine insurance consumer and the non-marine consumer differently. It is submitted that this situation may be a result of negligence. Article 222 of the Maritime Code is, basically, a copy of section 18 of the MIA 1906 (UK), while article 16 of the Insurance Law, to a large extent, refers to article 64 of the Insurance Law 1992 of Taiwan.[75] It is thought that these two laws were drafted by different legislators, so they negligently laid down two different basis which led to two different tests of materiality for non-disclosure or misrepresentation.

It is submitted that no matter whether this is the legislator's purpose or negligence, it is inappropriate to establish two different tests of materiality between marine and non-marine insurance in China. It is suggested that the test of materiality described in article 222 of the Maritime Code should be modified. The reasons are as follows:

(1) As was discussed earlier, the broad test of materiality is too harsh to insurance

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[74] [1984] 1 Lloyd's Rep 476.

[75] Art. 64 of the Insurance Law 1992 (Taiwan) states:
"When entering into a contract, written queries by the insurer shall be truthfully explained by the applicant and the insured.
If there is any false disclosure or wilful concealment in the proposer's answers to queries raised by the insurer, to the extent that the false disclosure or wilful concealment would sufficiently change or reduce the insurer's assessment for the risk in question, the insurer shall rescind the contract. It is so even after the risk occurs. However, this rule is not applicable to the case where the proposer proves that the

consumers even in England, let alone to Chinese insurance consumers who have less knowledge of insurance, at least for the time being, than those in England.

(2) The harshness of the broad test of materiality has been mitigated by the introduction of the requirement of inducement[76] in England. However, in China, no step has been taken to mitigate the harshness.

(3) In England, the test of materiality applies to both marine insurance and non-marine insurance, it is not necessary to establish two different tests of materiality for marine insurance and non-marine insurance in China.

Given that the test of materiality in marine insurance law is too harsh to the consumer, why not use the test of non-marine insurance – the prudent insurer decisive influence test for all insurance contracts?

4.6 Conclusion

It can now be concluded that the Chinese test of materiality should be determined as a "prudent insurer decisive influence" test. This test adopts the concept of the "prudent insurer" used in English insurance law, but abandons the harshness of the English "mere influence" test.

Through analysis of the test of materiality in England and Australia, it is clear and widely agreed that the English common law prudent insurer mere influence test of materiality is seriously biased against consumers and causes much criticism because of its harshness to consumers. So it is not ideal to follow completely the English test of materiality to determine the Chinese test of materiality. Because first, the English prudent insurer test is unsatisfactory in its own country.[77] Secondly, in China, insurance is a relative new thing compared with that in England, and as a number of people do not know insurance at all, it is not fair to use a harsh test for non-disclosure

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occurrence of the risk was not due to the fact he disclosed or did not disclosed."

[76] The requirement of inducement was produced in *Pan Atlantic Insurance Ltd v. Pine Top Ltd.* [1995] A.C. 501.

[77] Because according to comparative law, whenever it is proposed to adopt a foreign solution which is said to be superior, two questions must be asked: first, whether it has proved satisfactory in its country of origin, and secondly, whether it will work in the country where it is proposed to adopt it. It may well prove impossible to adopt, at any rate without modification, a solution tried and tested abroad because of differences in court procedures, the powers of the various authorities, the working of the economy or the general social context into which it would have to fit. See Konrad Zweigert, An Introduction to Comparative Law, p.16, Clarendon Press Oxford, 1987.

and misrepresentation. The English prudent insurer test, however, can be taken as a reference when considering how to determine Chinese test of materiality. The English requirement of inducement is not suitable to China. On the one hand, Chinese Insurance Law adopts the "prudent insurer decisive influence" test which is in favour of the proposer in contrast to the English "prudent insurer mere influence" test. It is not necessary to impose further burden on an actual insurer to prove the inducement. On the other, in China, all insurance companies use the same insurance policies and the similar proposal forms for the main types of insurance.[78] Generally, if a prudent insurer can prove that a fact is material, it would be presumed that the actual insurer has been induced to enter into the contract.

The Australian test of materiality - the reasonable insured test - seems to some extent to mitigate the harshness of the prudent insurer mere influence test to the insured, which is therefore considered by English authorities and law reformers to be followed as a model when reforming English law. However, I personally think that the Australian approach may not be suitable to the Chinese situation. This is because in the first place, Chinese people do not understand insurance as well as English and Australian people do, especially in the countryside in China where most people have even no idea about insurance and how can they know or be expected to know what matter is relevant to the decision of the insurer on whether he will accept the risk and, if so, on what terms. In the second place, it is a notorious fact that a reasonable man test would impose a standard which a great number of insureds would be unable to meet, especially in China where there are great differences in the insureds in relation to education, culture and commercial knowledge which affect their abilities to comply with the standard of the reasonable person test. In the cities, people have a higher education and more commercial knowledge, so such people are less at risk of making non-disclosure for the material information. In the countryside, people have lower education and poor commercial knowledge, and many people have never received education in school. However the reasonable insured test makes the assumption that all insureds are equally capable of reaching the required standard. This test is therefore not suitable to China, not only in the present but also in the near future.

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[78] The proposal forms and policies are drafted by the companies themselves, but they must meet the standard set up by the Financial Supervision and Control Department – the China Insurance Regulatory Commission.

Most Chinese insurers have high education and the knowledge of insurance as well as commercial experience. They know what facts would be material and what information they expect to be disclosed by the proposer. So it could be suggested that, in China the test of materiality should be determined as the prudent insurer decisive influence test subject to the limitation of the questions in the proposal form rather than the English prudent insurer mere influence test for voluntary disclosure. Whether or not the Australian reasonable insured test could be adopted in China following the further development of insurance is a question which may be answered in the future.

Article 222 of the Maritime Code which provides a broad test of materiality, namely the "prudent insurer mere influence" test could be modified by referring to article 16 of the Insurance Law.

5. The basis of the contract clause[79] and the test of materiality

As was discussed above, in China the insurer must satisfy two conditions before he can avoid a contract on the grounds of non-disclosure or misrepresentation. (1) The non-disclosed or misrepresented fact must be within the scope of the questions asked by the insurer in the proposal form. (2) The non-disclosed or misrepresented fact must be material by the prudent insurer decisive influence test as established in article 16 of the Insurance Law. However, it does not mean that the insurer has no right to avoid the contract or reject liability if the proposer fails to answer other questions honestly than those which are regarded as material facts. Another way that may enable an insurer to avoid a contract or repudiate a liability where the proposer fails to perform his duty of truthfully answering the questions is the application of the "basis of contract" clause in the proposal form.

A basis of contract clause is usually a particularly potent method of creating a

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[79] The basis of the contract clause is treated and discussed in the topic of warranty in English works, but as warranty is not considered in this thesis separately, it is convenient to examine the basis clause in this chapter because it is closely related to the test of materiality of non-disclosure and misrepresentation.

warranty, the effect of which also originates from English common law[80]. This clause sometime completely precludes the test of materiality of non-disclosure and misrepresentation. Matters of this clause are usually dealt with in the topic of warranty, but as it is closely linked to non-disclosure and misrepresentation, it is convenient to discuss it in this chapter. As this clause is presumed to be introduced from England to China, it is therefore better to examine it from its origin in England.

5.1 The Genesis of the Basis Clause and Its Application in England

Briefly speaking, the basis of the contract clause in insurance stemmed from life policies in the first third of the nineteenth century. For insurance, in the old cases of *Everett v. Desborough*[81] and *Duckett v. Williams*[82], the basis of the contract clause was used. Another old case, which is often cited by writers when talking about the basis of the contract clause and materiality, is *Thomson v. Weems.*[83] In that case questions on the proposal form asked: (a) "Are you temperate in your habits and (b) have you always been strictly so?" The insured answered "(a) temperate; (b) yes." The form contained a basis clause which expressly said that, in the event of an untruth, the policy would be void. As the insured was in fact a heavy drinker, the insurer successfully avoided liability for breach of an express warranty. The House of Lords had no difficulty in upholding the insurer's repudiation of liability. Materiality, they said, was irrelevant, even though, in fact, the matter must have been material on the facts of the case. A later case of *Dawsons Ltd v. Bonnin*[84] completely precluded the operation of the test of materiality of non-disclosure and misrepresentation. A firm wished to insure a lorry. In answer to the question, "where will the lorry be usually garaged?" it was wrongly answered "at an address in central Glasgow". The lorry was usually garaged on a farm on the outskirts of Glasgow. This was an innocent misstatement. There was a fire at the garage, which damaged the lorry. The insurer technically rejected the claim by virtue of the effect of the basis clause. The address where the lorry was actually garaged was much less risky for the lorry than that misstated. If the

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[80] See *Everett v. Desbrough* (1892) 5 Bing 503; *Duckett v. Williams* (1834) 2 M 348; See also *Thomson v. Weems* (1884) 9 App. Cas. 671.
[81] (1829) 5 Bing 503.
[82] (1834) 2 M 348.
[83] (1884) 9 App. Cas. 671.
[84] [1922] All E.R. Rep 210.

case had been defended by the insurer on the grounds of breach of good faith, it might have been possible for the insured to argue that the farm address was more beneficial to the insurer than central Glasgow. Unfortunately, the House of Lords, basing itself on notions of freedom of contract, held that the clause ousted the need for materiality and was not restricted in its operation by the insurer's contractual right to avoid liability where materiality could be proved. It is clear, from these cases, by virtue of the basis of the contract clause, all answers in the proposal form are accorded the status of warranties, the breach of which would enable the insurer to avoid the contract entirely, irrespective of the issue of the test of materiality, and irrelevant to the issue of whether or not the proposer has answered the questions honestly or to the best of his knowledge and belief if, in fact, answers are inaccurate. An incorrect answer, whether fraudulent, negligent or innocent and whether material or not will allow the insurer to avoid liability.

5.2 The restriction of the application of basis clause in England[85] and Australia

In England, historically, the "basis of contract" clause was widely used by insurers to create a warranty in a proposal form. Insurers may successfully avoid a policy by using the clause where an insured makes a misstatement. The insurers succeeded in equipping themselves with a potential defence to an action on the policy much wider than that arising by virtue of the duty of disclosure.[86] In England, the way of voluntary disclosure has been adopted, over and above correctly answering the questions in the proposal form there remains upon the proposer the residual duty of disclosure, *i.e.* a duty to volunteer information which is material to the risk although such information is not solicited on the proposal form. The "basis of contract" clause has therefore partially eclipsed the law relating to non-disclosure and misrepresentation in England. This strict legal position of the basis of the contract clause has attracted considerable criticism, and it is noteworthy that judges have been as critical as other commentators.[87] The ABI Statements of Insurance Practice have mitigated the strict

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[85] As to the criticism and the restriction of the basis of the contract clause in England, see Professor J.E. Adams, *Basis of the Contract Clauses and the consumer,* [2000] J.B.L. pp. 203 – 213.
[86] See *Thomson v Weems* (1884) 9 App. Cas. 671; *Dawsons ltd v. Bonnin* [1922] All ER Rep 210; see also the case of *Provincial Insurance Co v. Morgan* [1933] A.C.240.
[87] The leading criticisms are referred to by the Law Commission, Report No. 104, at 7.2 and 7.3.

legal position by providing their own practice in the Statements.[88] So the device of the "basis of contract" clause may not be so wide-ranging in its effects as it has been.[89] Although little used today, the clause still appears on some proposal forms of insurers who are members of the ABI.[90] Law reformers recently strongly recommend that the only solution to the continuing use of the basis contract clause is to outlaw them altogether, as the UK's Law Commission recommended in 1980 and as the 1984 Australian legislation has already done. The National Consumer Council of UK recommended a legal prohibition on this clause in its 1997 Report on Insurance Law Reform.[91] In the Australian ICA 1984, section 24 removes from the realm of warranty or condition any statement by the insured as to the existence of a state of affairs made in or in connection with a contract of insurance. Hence a "basis of the contract" clause which creates an insurance warranty and make the accuracy of statements in the proposal form a condition of the validity of the contract is no longer of any effect in Australia, for such statements are now, by virtue of section 24, to be regarded as mere representations and not as vital terms of the contract. Consequently, the test of materiality of non-disclosure and misrepresentation can play its role properly.

5.3 The application of the basis clause in China

In China, to date, the "basis of contract" clause has been widely used in various insurance proposal forms.[92] For example, in the "questionnaire and proposal for construction all risks insurance" of the PICC, a clause states at the end of the form: "We hereby declare that the statements made by us in this questionnaire and proposal are, to the best of our knowledge and belief, complete and true, and we hereby agree

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[88] In the Statement of General Insurance Practice of the ABI, s.1(a) and (b), it is provided: (a) The declaration at the foot of the proposal form should be restricted to completion according to the proposer's knowledge and belief; (b) Neither the proposal form nor the policy shall contain any provision converting the statements as to past or present fact in the proposal form into warranties. However insurers may require specific warranties about matters which are material to the risk.

[89] In most new proposal forms of the ABI members, the "basis of contract" clause has been abolished. For example, in the old proposal form for private car insurance, the "basis of contract" clause was found, while in the new proposal form, this clause has disappeared. However, it is still used by some insurers.

[90] See Endsleigh proposal forms for the building and contents insurance for private landlords, student possessions insurance and student car insurance, etc.

[91] See Professor J. Birds, Insurance Law reform, The Consumer Case for a Review of Insurance Law, p.71, Published by the British National Council, 1997. See also Professor J.E. Adams, Basis of the Contract Clauses and the Consumer [2000] J.B.L., p.207, in which he proved that the basis clause still remains in use by some ABI members.

[92] In China, this clause is widely used in both life insurance and non-life insurance proposal forms. See

that this questionnaire and proposal form the basis and is part of any policy issued in connection with the above risks." The widespread application of the clause renders the test of materiality completely meaningless. This is because the breach of this clause enables the insurers to avoid the contract entirely, and it is irrelevant whether the untrue statement is material or not. Again, in China, as the duty of disclosure by the proposer is performed by correctly answering the questions on the proposal form, the proposer is relieved from performing the further duty of disclosure. The test of materiality operates within the scope of the questions which appear on the proposal form. However, if there is an incorrect answer given in the proposal form in which there is no such a "basis of contract" clause, the test of materiality will play its role properly and the insurers will only avoid the contract if they can prove that by giving an incorrect answer the proposer has failed to disclose or misrepresented a material fact.

A more difficult problem arises in some Chinese insurance proposal forms, namely, if the proposal form contains another clause to emphasise the materiality which is not identical in scope with the basis of the contract clause, then is the basis clause affected by the other clause? For example, in the proposal form of life insurance of the Ping An Insurance Company, at the beginning of the proposal, it warns the proposer to perform the duty of utmost good faith, stating: "According to article 16 of the Insurance Law, where the proposer fails to perform his duty of disclosure or truthful representation to the insurer of the facts intentionally or negligently which shall sufficiently influence the insurer on making a decision as to whether he will accept the risk or on fixing the premium rate, the insurer has the right to rescind the contract. Therefore, the proposer should truthfully answer the questions asked in the proposal form and should not omit to state, conceal or misrepresent any information." By this clause, it seems that the insurer has the right to avoid the contract only where the non-disclosed or misrepresented information is material and would decisively influence the insurer's decision in respect of the acceptance of the risk or the premium rate. However, at the bottom of the proposal form, a basis of the contract clause states: "I declare that I have not kept back any information which should be provided to the insurer and the information provided is completely true. I agree that the proposal shall be the basis and

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proposal form for property insurance and life insurance proposal forms and others.

form part of the contract between myself/ourselves and the company. If there is any concealment or misstatement, the company can rescind the contract and repudiate liability." According to this clause the insurer has the right to avoid the contract if there is any untrue statement or non-disclosure irrespective of its materiality. In the absence of any comment and judicial decision on this point, it is submitted that two situations may arise under these circumstances:

(1) Presuming that all questions raised in the proposal form are material, the two clause completely overlap and are identical in scope. Consequently, either clause may be used by the insurer to repudiate liability;

(2) If not all the questions raised in the proposal form are material, but only some of them are material, the basis clause and the material clause are not completely identical (although substantially overlapping), and so the basis clause may render the materiality clause completely superfluous.

The concept of warranty and condition is not mentioned in Chinese insurance law, but, according to the English common law, the basis of the contract clause is the easiest way of creating an insurance warranty. Once the proposer warranted the answer he was bound by its consequences. Where there were two provisions in the proposal form, one is the basis clause, and another is the materiality provision, the English approach is that the effect of the recital was not cut down by a condition to the effect that "material misstatement or concealment of any circumstance by the insured material to assessing the premium herein or in connection with any claim shall render the policy void", since the latter condition was not rendered nugatory by the "basis of the contract" clause.[93] Many authorities confirm this view.[94] Thus, the materiality clause did not have the effect of restricting the "basis of the contract" clause in the proposal form. As R.A. Hasson comments when he criticises the decision of *Dawsons* that "in order to give meaning to a single word (basis), a whole provision (materiality provision)[95] is sacrificed!" However, since the law does not prohibit the basis clause to appears in the proposal form and create a warranty, the court can do nothing but

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[93] *Dawsons ltd v. Bonnin* [1922] All E.R. Rep 210.

[94] For the details, see MacGillivray, (9th ed.), para. 10-29, 1997; and see also R.A. Hasson, *The "basis of the contract clause" in insurance law,* [1971] M.L.R. pp. 29 - 38.

[95] In *Dawsons ltd v. Bonnin* there was a condition term stated: "material misstatement or concealment of any circumstances by the insured material to assessing the premium herein, or in connection with any claim, shall render the policy void."

enforce it, because both the insurer's right based on the basis clause and that based on the materiality provision are contractual rights. He can exercise any of them to repudiate liability for untrue information made by the proposer in law. In *Dawsons*, the House of Lords, basing itself on notions of freedom of contract, held that the clause ousted the need for materiality and was not restricted in its operation by the insurer's contractual right to avoid where materiality could be proved.

Despite the widespread use of the "basis of contract" clause in China, no reported cases have been found in which the insurer avoided a policy or repudiated liability by relying on this clause. It is submitted that there are two reasons: (1) the basis of contract clause is introduced from England, and some proposal forms are translated from English, so most insurers themselves do not understand the meaning and the function of the basis clause, and they are, therefore, unable to use it technically to defend the proposers' misstatements; (2) some insurers know the meaning of the clause, but they are unwilling to use it simply because they want to keep their consumers for renewal of their policies. In practice, however, this clause is partly in operation in the sense that the insurer can hold this card to bargain with the proposer in dealing with the claim where the proposer gave an untrue statement in the proposal form.[96]

5.4 Conclusion and suggestions

There is no doubt that if the basis clause is allowed to exist in the proposal in China, it sooner or later will play its "role" when the insurers know its function. The insurance consumers in China do not understand the basis clause at all, so its existence is a potentially dangerous "trap"[97] for an innocent proposer who honestly gives wrong information or whose misrepresentation is trivial but not material for the insurer to make his decision as to whether or not he will cover the risk or what premium will be charged. On the other hand, more and more foreign insurers establish their companies in China, they clearly understand the basis clause's function, and they may take the

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[96] Personal discussion with Mr Zhao Bo, the deputy manager, the People's Insurance (Property) Company of China, Ltd, Property Insurance Department Enterprise Property Insurance Division, who came to London for a insurance training course in September 1998.

[97] In the case of *Zurich Insurance Co. v. Morrison* [1942] 1 All E.R. 529, at 537, Lord Greene M.R. pointed out that the basis clause creates "traps" for the insured. In the same opinion, his Lordship described the basis clause as a "vicious" device.

chance to use this clause as a defence to repudiate liability.[98]

As was mentioned above, in England, in practice, the basis of the contract clause is not used by the ABI members any more (except few "offending" companies), and, in Australia, the ICA 1984 expressly abolishes the usage of a provision which convert the statements as to past or present fact in the proposal form into warranties, like the "basis of the contract" clause, because such statements in the proposal form are regarded as mere representations under the 1984 Act. It is regretful that when the harshness and unfairness of the basis clause has been seen and abandoned in both England and Australia, it is still used in China. Several recommendations may solve this problem.

(1) Abolish the basis clause altogether from the proposal form, and leave the materiality provision operating properly which is written in the beginning of the proposal form, it is reading: "The insurer shall have right to rescind the insurance contract where the proposer witholds or misstates facts deliberately or by negligence, which is sufficient to influence the insurer's decision on whether he will accept the insurance or raise the premium rate." As according to the original purpose of the introduction of the basis clause, namely, to draw the attention of applicants for insurance to the fact that the information required of them was very important,[99] the materiality clause is sufficient to draw the proposer's attention to

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[98] One practical problem needs to be mentioned here. It is interesting to note that the wording about the 'basis of contract' clause in the proposal form of property insurance has two different meanings between the Chinese version and English version (This proposal form uses two languages, Chinese and English). In the Chinese version, the clause declares: " ..... and hereby agree that this proposal form shall form the basis of the contract, ... ", but its English version reads: ".... and hereby agree that the proposal be incorporated into the policy,....". This is most likely a mistake in translation from Chinese into English, but the legal consequences of these two meanings are quite different. According to the meaning of the Chinese version, the contract could be entirely avoidable in the event of any untruth in the proposal form; but according to the translated English meaning, only where the untrue statement is material does the insurer have the right to avoid the contract. This mistake needs to be clarified as soon as possible. Otherwise, the two different meanings will inevitably cause disputes. When the insurer relies on the Chinese meaning of this clause to avoid a policy where an untrue statement is given in the proposal form, the native Chinese consumer who understands the English meaning, and a foreign consumer, if any, would defend himself by the English meaning. This problem must cause difficulty for courts in making a decision. It could be suggested that the court might handle this problem according to art. 30 of the Insurance Law, which states "When a dispute arises between the insurer and the proposer, the insured or the beneficiary over the terms and conditions of an insurance contract, the People's Court or arbitration organisation shall interpret such terms and conditions in favour of the insured and the beneficiary."

[99] See R.A. Hasson, *the "Basis of the contract clause" in insurance law,* (1971) 34 M.L.R. p.38. He comments that "It seems reasonably certain that the basis of the contract clause was originally introduced into insurance polices in the early part of the nineteenth century with the purpose of drawing the attention of applicants for insurance to the fact that the information required of them was very important. The basis of the contract clause has long since served to reform this "educative" function efficiently. ...

the need to answer the questions truthfully.

(2) If there is no materiality clause as described above at the beginning of the proposal form, at the end of the proposal form, the declaration may be provided: "I declare that to the best of my knowledge and belief all the statements and particulars made with regard to this proposal are true and I apply for a contract of insurance with the company to be expressed in the usual terms of the company. If there is any untrue statement which is sufficient to influence the insurer's decision on whether he will accept of the risk or on fixing premium rate, the insurance company may rescind the contract or repudiate liability."

(3) Alternatively, if the "honest man" approach is adopted as the test of materiality, the declaration would say that "I declare that to the best of my knowledge and belief all the statements and particulars made with regard to this proposal are true and I apply for a contract of insurance with the company to be expressed in the usual terms of the company. If there is any statement which I know or should have known to be untrue, the insurance company shall rescind the contract or repudiate liability.

6. Effect of Non-disclosure or Misrepresentation

Whether or not a person breaches the duty of utmost good faith is based on two factors, one is the subjective factor, namely, whether he acted wilfully or negligently. The other is the objective one, *i.e.* the fact he withheld or misrepresented is material. Once the breach of the duty has been ascertained, a consequence for the breach would be imposed on that person. Different effects have been established in different countries.

6.1 The Chinese approach

Article 16 of the Insurance Law tackles the question of what the effect is of non-disclosure and misrepresentation. This article makes it clear that where the proposer conceals material facts or gives wrong information when the contract is formed, the insurer may rescind the contract no matter whether the non-disclosure or

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As it is, the basis of the contract clause performs little or no "educative" function and, instead, as Lord Greene M.R. pointed out in *Zurich Insurance Co. v. Morrison*, [1942] 1 All E.R. 529, it creates "traps" for the insured.

misrepresentation has been caused by fraudulence or negligence.[100] However, if there is an occurrence of the insured event before the rescission of the contract, the situation is not so simple. A rule of causal connection is introduced under this circumstance. From article 16, two different effects are reflected:

(1) The effect is different between a fraudulent and negligent non-disclosure or misrepresentation in terms of the refunding of the premium paid by the proposer;

(2) For a negligent non-disclosure or misrepresentation, if the insured event has occurred, the effect is different depending on whether the fact not disclosed or misrepresented by the proposer has a heavy impact on the occurrence of the insured event.

By virtue of article 16(3), "Where the proposer fails to perform his duty of disclosure or truthful representation of information to the insurer deliberately, the insurer shall not be liable for the payment of insurance moneys in connection with the event insured against that occurrs prior to the rescission of the contract, and shall not refund the premium." Consequently, the effect of a proposer's fraudulent breach would be that not only would the insurer be relieved from the liability of paying the insurance money but also would retain the premium paid by the proposer. According to article 16(4), "Where the failure of the proposer to perform his duty of disclosure and truthful representation as a result of a mistake has a *serious impact* on the occurrence of events insured against, the insurer shall not be liable for payment of insurance moneys in connection with events insured against that occur prior to the rescission of the contract, but may refund the premium."[101] This sub-article indicates that for the negligent non-disclosure or misrepresentation, only where the occurrence of the insured event is seriously impacted by or causally connected to the information concealed or misrepresented by the proposer, may the insurer avoid the contract *in toto*. The insured cannot recover from the insurer for the losses or damages occurred before the avoidance of the contract but the premium can be refund. This sub-article also implies that if the negligent non-disclosure and misrepresentation has *light* or *no impact* on the occurrence of the event insured against, that is where there has been no causal connection between the occurrence of the insured event and the concealed or misstated information, the insurer shall be liable for payment of insurance moneys for the losses

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[100] Art. 16(2) of the Insurance Law.

or damages that occurred prior to the rescission of the contract.[102]

One question is not very clear in article 16 of the Insurance Law. The law does not expressly stipulate whether the term "avoid the contract" means that the insurer may avoid the contract *ab initio* or just for the future from the moment of the avoidance by the insurer. This point is usually irrelevant, but circumstances may arise in which it is important. If, for example, there have been two or more occurrences of the insured events under the same policy, and the insurer discovers the non-disclosure or misrepresentation when he deals with the last occurrence and seeks to avoid the policy, it is very material to know the moment in time from which the policy is deemed to be avoided. If the contract were avoided for the future from the moment of avoidance, the insured would recover for his earlier losses. If the avoidance operates *ab initio, i.e.* it is retroactive, the insured would recover nothing. By inference from article 16, it may be concluded as follows: for fraudulent non-disclosure or misrepresentation and negligent non-disclosure or misrepresentation which has a *serious impact* on the occurrence of the insured event, the insurer has the right to avoid the contract *ab initio.* This is because in these situations the insurer is entitled to avoid the contract and to repudiate liability for the losses which occurred prior to the avoidance.[103] However by the implied meaning of article 16(4), where the negligent non-disclosed or misstated fact has *light or no impact* on the occurrence of the insured event, the avoidance will operate merely from the moment when the contract is rescinded and the insurer is liable for losses occurred before the avoidance.

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[101] See note 25 *supra.*

[102] By comparing art. 16(4) of the Insurance Law with art. 223 of the Maritime Code, it is not difficult to discover that in regard to remedy for negligent non-disclosure or misrepresentation, the Insurance Law seems to be in favour of the insurance consumers. According to art. 223 of the Maritime Code, the consequence for a fraudulent non-disclosure is similar to that treated by art. 16(3) of the Insurance Law, but the consequence for a negligent non-disclosure or misrepresentation is different from that treated by art. 16(4) of the Insurance Law. By virtue of art. 223 of the Maritime Code, the insurer shall not be liable for a loss which occurred before the avoidance of the policy if the non-disclosed or misstated information has only *an impact*, no matter whether it be light or serious, however art. 16(4) stresses the word *serious*, this means that only where the non-disclosed or misstated information has a *serious impact* on the occurrence of the insured event, the insurer has right to repudiate liability for the losses or damages suffered by the insured prior to the avoidance of the policy. This clearly reflects the law drafter's increased tendency towards the protection of the insurance consumer.

[103] As far as the refund of the premium is concerned, the law provides that for fraudulent non-disclosure or misrepresentation, after the avoidance of the policy, the insurer shall not refund the premium to the proposer. For negligent non-disclosure or misrepresentation, after the avoidance of the policy, the insurer should refund the premium to the proposer. See art. 16 (3) and (4) of the Insurance Law.

The test of materiality can not operate properly in the light of the rule of causal connection. For example, where a person had a heart problem when he took out the life insurance, but he negligently misstated the fact by giving a negative answer to the question whether or not the life insured had heart disease, this fact was material, and the insurer would have refused to conclude the contract had he known it. However, the insured was killed in a car crash, and the insured was liable to pay according to article 16 (4), for the insured's death was not connected at all with heart disease although the non-disclosed information was so material. It is submitted that the notion of causal connection is not suitable to be adopted here, the reason being that whereas the duty of disclosure or truthful representation should be performed when the contract is formed, the test of materiality is based on whether the insurer would refuse to accept the risk or increase the premium, but not on whether the fact would impact the occurrence of the future event insured against.

It is suggested that the effect should be: where the non-disclosure or misrepresentation is not fraudulent (1) if the withheld fact is so material that the insurer would have refused to cover the risk had he been disclosed, the insurer can avoid the contract totally *ab initio*; (2) if the withheld fact is so material that the insurer would have demanded a higher premium if he had known the fact, the insurer can require the proposer pay a larger premium before a loss has occurred, or the insurer may pay the proposer a portion corresponding to the premium he has actually paid if the event insured against had occurred before the non-disclosure or misrepresentation has been discovered.

Another question which merits a special discussion is the time limitation for the exercise of the insurer's right to rescind the contract when he discovers the proposer's breach of the duty of utmost good faith. Neither the Insurance Law nor the Maritime Code deals with this question. Sometimes it is found that insurers abuse their right of avoidance of an insurance contract on the defence that the proposer has not disclosed a material fact. This point is illustrated by a Chinese case.[104] The fact was that the proposer took out all risk insurance for his ship which was rebuilt (or remoulded) from an old ship. However, due to the fact that the certificate of the ship still retained the

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[104] See CNLA (China Maritime Law Association) News Letter (1999) No.48, p.17.

words of the "date of the building" and the "manufacturer of the building" rather than the "date of the rebuilding" and the "manufacturer of the rebuilding", the proposer filled in the proposal form by giving information about the ship according to the certificate and he did not disclose the fact that the ship was rebuilt from an old ship. The agent of the insurer knew the fact that the ship had been rebuilt and checked the ship in the port before the conclusion of the contract, but he did not ask the proposer any further questions about this. The contract was concluded and renewed later. The ship was destroyed by a collision with another ship after the renewal of the policy. The insurer rejected the liability on the ground that the proposer failed to disclose the material fact of the rebuilding of the ship. The court rejected the insurer's argument and held that the insurer was liable.

Several questions arise in this case. First, whether it amounts to a waiver where the insurer or his agent did not avoid the contract after he knew the non-disclosure or misrepresentation of the proposer; Secondly, if it is not a waiver, how long is the time limit before the insurer exercises his right of avoidance of the contract? From this case it is understood that the insurer did not admit that he waived his right, but the court's decision showed that the insurer's silence and non-action of the avoidance instituted a waiver of his right of avoidance of the contract. Under this circumstance, it is submitted that the law should add a provision relating to the time limit for the insurer's exercise of his right. It is suggested that Taiwan's approach should be taken in respect to this question. Article 64(3) of the Insurance Law of Taiwan 1997 provides: "The right to rescind the contract referred to in the preceding paragraph[105] shall be extinguished if it is not exercised within one month after the insurer knows the reason for rescission; however, even if there is a reason to rescind the contract, the contract may not be rescinded two years after the execution of the contract." This stipulation is for life policies and this does not affect non-life policies which are annually renewed policies. It is submitted that for non-life policies, the first half of article 64(3) ought to be made to apply, namely, "the right to rescind the contract referred to in the preceding paragraph shall be extinguished if it is not exercised within one month after the insurer knows the reason for rescission." It is suggested that the "one month" period is too short and should be altered to "three months".

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[105] The preceding paragraph refers to the right of rescission of the contract on the proposer's non-

6.2 The English solution – all or nothing

The rule of the effect of non-disclosure stemmed from the principle of utmost good faith. In the leading case of *Cater v Boehm,* the effect of non-disclosure was determined by Lord Mansfield, "..... The keeping back of such a circumstance is a fraud, and therefore the policy is void." Following the development of the principle of utmost good faith, the effect of non-disclosure is stipulated in insurance laws. In the MIA 1906 (UK), it is stipulated in s.18 that if the insured fails to make such a disclosure, the insurer may avoid the contract. The avoidance is retroactive, *i.e.* the insurer is entitled to avoid the contract *ab initio,* and not merely for the future, from the moment of the avoidance by the insurer.[106] That the contract is avoid *ab initio* means the contract has never existed, the insurer has never been at risk, and the insured is therefore entitled to recover the premiums paid unless his non-disclosure or misrepresentation was fraudulent.[107] However, where there is a forfeiture provision in the policy, the premium need not be refunded to the insured.[108]

As the law relating to non-disclosure and misrepresentation operates unfairly against the interests of the innocent insured person, the all-or-nothing remedy for the breach of the duty is not reasonable. The British Insurance Ombudsman has indicated that it is no longer appropriate for insurers to have the right to avoid a policy *in toto* for every breach of duty, and that a proportionate award to the assured may be a fairer result, particularly where the insured has not been fraudulent and the loss was not causally connected to the information misstated or withheld.[109] The rule of proportionality also

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disclosure of material fact.

[106] See Macgillivray on Insurance Law, (9th ed.), para. 17-29, p. 401, 1997.

[107] See *Anderson v. Fitzgerald* (1853) 4 H.L. Cas. 484; see also J. Birds, Modern Insurance Law, (4th ed.), pp158-159, 1997.

[108] In some policies a provision appears: "..... If we discover that an untrue statement was made or that any material fact was not disclosed or was stated incorrectly, we have the right to cancel the policy within six months of discovery and to retain all premiums paid to us ....." See *Thomson v. Weems* (1884) 9 App. Cas. 671.

[109] IOB Bulletin No. 3, 1994, p.5. And recently the British National Consumer Council suggested that "if a misrepresentation or non-disclosure is non-fraudulent, the insurer retains liability under the policy but is entitled to deduct the extra premium it would have charged had there been no non-disclosure or misrepresentation. The contract can be avoided only where there is fraudulent non-disclosure or misrepresentation or it would not have insured the risk." See J. Birds, Insurance Law Reform, The Consumer Case for a Review of Insurance Law, p.69, 1997.

applies in some European countries, such as France,[110] Denmark[111] and Finland. The rule is that, in the case of wilful misrepresentation or non-disclosure of material information, the contract is nullified, but, if they are not wilful, the insurer pays that proportion of the claim which the premium paid bears to the premium that would have been paid if the insurer had been given full and correct information. The attraction of this rule mitigates the "all-or-nothing" remedy employed by England and China for the breach of the duty of utmost good faith. It is worthwhile to be referred to when modifying Chinese law in respect to the effect of the breach.

6.3 The Australian approach

In Australia, sections 28 to 33 of the Insurance Contracts Act 1984 deal with the remedies for non-disclosure and misrepresentation. By virtue of section 28, if the insured failed to comply with the duty of disclosure or made a misrepresentation to the insurer before the contract is entered into, the remedies are: (1) if the failure was fraudulent or the misrepresentation was made fraudulently, the insurer may avoid the contract;[112] (2) if the breach of the duty of disclosure and correct representation was made innocently, there is no avoidance of the contract being allowed, and instead "the liability of the insurer in respect of a claim is reduced to the amount that would place him in a position in which he would have been if the failure to disclose had not occurred or the misrepresentation had not been made.[113] In responding to the remedies of an innocent non-disclosure or misrepresentation, several situations might arise. (a) if the insurer can demonstrate that he would have refused the insurance if he had known the true fact, he is not liable for the claim but the premium should be refunded to the insured: (b) if the insurer can only show that he would have applied an excess or would have inserted some exclusionary or other clause, he would be entitled to apply the excess or rely upon the clause, as the case may be, in reduction of the claim in question.[114] However, there are conflicting authorities on the first situation. One opinion is that "it would only be in a very extraordinary case" that the court would give

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[110] See Code d'assurance, Article 113-8 and 113-9 of France.
[111] See Insurance Contracts Act 1930, s. 16(2) of Denmark.
[112] The ICA 1984 (Australia) s. 28(2).
[113] *Ibid.*, s. 28(3)
[114] See A.A. Tarr, Australian Insurance Law, p.90, The Law Book Company Limited, 1987.

the phrase "reduce the amount" the meaning of reduction to nil[115]. Another is that "... if the circumstances be appropriate, the reduction to nil is to be given effect."[116] It is submitted that the later opinion reflects the legislature's real meaning that "the liability of the insurer in respect of a claim is reduced to the amount that would place him in a position in which he would have been if the failure had not occurred or the misrepresentation had not been made."

However, such remedies do not apply where "the insurer would have entered into the contract, for the same premium and on the same terms and conditions, even if the insured had not failed to comply with the duty of disclosure or had not made the misrepresentation."[117]

6.4 Conclusion

As to the remedies for non-disclosure and misrepresentation, in order to punish a fraudulent breach of utmost good faith, insurance laws in different countries reach a same remedy to the effect that the insurer is allowed to avoid the contract *ab initio* if the non-disclosure or misrepresentation is fraudulent.[118] For this point, there is no point of issue in different countries. It is my submission that, for a fraudulent non-disclosure or misrepresentation, some legal consequences should be imposed on the fraudulent person. This is because where an insurer is entitled to avoid a contract of insurance for fraudulent misrepresentation or non-disclosure, the only loss of the fraudulent customer is the non-refund of the premium he has paid.[119] Is this not too generous to him? If the fraud were successful, the fraudulent customer would make a

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[115] This was the opinion of Yong J of the New South Wales Supreme Court in *Advance (NSW) Insurance Agencies Pty Ltd v. Matthew* [1987] 4 ANZ Ins Cas 60-813 at 74,999-75,000.

[116] This was the opinion of Giles J in *Ferrcom Pty Ltd v. Commercial Union Assurance Co of Australian Ltd,* [1989] 1 ANZ Ins Cas 60-907 and Rogers CJ in *Lindsay v CIC Insurance Ltd,* (1989) 16 NSWLR 673. For the details of the different views in respect to the remedies for innocent non-disclosure and misrepresentation, see A.A. Tarr, *The Insurance Contracts Act Revisited,* [1991] vol. 4, I.L.J. pp. 224-230.

[117] The ICA 1984 (Australia), s. 28(1).

[118] See art. 16 (2) and (3) of the Insurance Law 1995 (PRC); S. 28(2) of the ICA 1984 (Australia); however according to s. 18 (1) of the MIA 1906 (UK), the insurer may avoid the contract not only for a fraudulent breach but also for an innocent non-performance of the duty of utmost good faith although its harshness has been heavily criticised.

[119] See art. 16 (3) of the Insurance Law; s. 84 (1) of the MIA 1906 (UK), it provides: "Where the consideration of the payment of the premium totally fails, and there has been no fraud or illegality on the part of the assured or his agents, the premium is thereupon returnable to the assured."

profit from the payment of the insurance money which he would not have got if he had disclosed the fact. In China, a number of cases concerning non-disclosure and misrepresentation are in relation to fraud. This is especially so in life insurance, a proposer or an insured deliberately conceals the insured's health problems which are material to the insurer in making a decision on whether or not he will accept the insurance or raise the premium rate. For example, in a Chinese case,[120] the proposer effects a life policy for the insured sum of RMB 260,000 on the life of his son who had got an inborn heart problem and who had also suffered several serious diseases. The proposer denied the fact when he answered the questions in respect to the insured's health as required by the insurer in the proposal form. The son died one year after the conclusion of contract. The insurer prepared to pay the claim without knowing the concealment of the material fact. It was fortunate that, just before the payment of the insurance money, the non-disclosure was discovered. The insurer refused to be liable and retained the premium according to article 16(3) of the Insurance Law. The only loss to the proposer was the premium of RMB 2,000, but the insurer's expenditure on the investigation of the real fact and on obtaining the evidence of the fraudulence was much higher than the amount of the premium paid by the proposer. The insurer had no way out in the face of the law. It is submitted that financial punishment should be imposed on the fraudulent proposer, in order to reduce fraud in respect to non-disclosure and misrepresentation.[121]

The rule of causal connection adopted in the Insurance Law is inconsistent with the concept of the principle of utmost good faith, simply because the objective factors for a breach of the duty of utmost good faith do not depend on whether the non-disclosed or misrepresented fact bears relationship to the loss occurred but depends on whether it has decisive influence on the insurer's decision for fixing the premium or determining whether he will take the risk. It is therefore submitted that the remedies for a breach should not partly rely on whether the non-disclosed or misrepresented fact has a serious impact or a light impact on the occurrence of the insured event in addition to the

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[120] See Zhongguo Baoxian Bao (China Insurance News) No. 526, July 1999.

[121] In art. 131 of the Insurance Law, some legal liability is imposed on the proposer or insured who acts fraudulently in insurance activities, but it does not include fraudulent non-disclosure or misrepresentation. It is suggested that where the proposer has fraudulently concealed or misrepresented material facts and caused the insurer expenses to investigate the true fact, the proposer should be liable to cover the insurer's cost for this investigation.

materiality. In fact it is very difficult to determine a "serious impact" and a "light impact".[122] On the other hand, as was discussed above, the rule of causal connection may render the materiality partly meaningless because in certain circumstances the losses are not caused by the non-disclosed or misrepresented fact. Further this may encourage the proposer to make negligent non-disclosure and misrepresentation by taking a chance that the misrepresentation has no relationship or little relationship with the loss. It is suggested that it is better not to use the rule of causal connection in this article. For the remedy of the non-disclosure and misrepresentation, some suggestions are made which are arranged in Chapter six.

7. The Duty of Disclosure and Answering the Questions in the Proposal Form

There are two types of disclosure. One is voluntary disclosure, *i.e.* the parties are bound to volunteer to each other before the contract is concluded all information which is material. The other is inquiring disclosure, *i.e.* the proposer is required to truthfully answer the questions inquired by the insurer on the proposal form. English law and Australian law have adopted the way of voluntary disclosure[123] and Chinese insurance laws have employed the ways of inquiring disclosure for non-marine insurance[124] and voluntary disclosure for marine insurance[125]. Which way is better depends on whether it is suitable to the country's situation.

7.1 Voluntary disclosure required in English law and Australian Law

Section 18(1) of the MIA 1906 (UK) provides that "... the assured must disclose to the insurer, before the contract is concluded, every material circumstance which is known to the assured, and the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him..." It is clear that in England the duty of disclosure is not synonymous with the obligation to correctly answer the questions on the proposal form. The proposal form is just one of the means by which

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[122] It is thought that it leaves the court some discretion in determining what is for "serious impact" and what is "light impact", and in the burden of proof imposed on the insurer, the evidence of a relevant expert is needed to determine the causation of the loss.
[123] See s.18 of the MIA 1906 (UK) and s.21 of the Australian ICA 1984.
[124] See art. 16 of the Insurance Law.
[125] See art. 222 of the Maritime Code.

the disclosure of material facts can be made, so the proposer is not relieved from his duty by merely correctly answering the questions therein. He is bound not only to make true answers to the questions put to him but also to spontaneously disclose any fact exclusively within his knowledge which is material for the insurer to know. Thus, if a burglary insurance proposal form asks questions chiefly concerned with the nature of the proposer's premises and the business carried on there, this will not of itself relieve him of his duty to disclose material facts relating to his personal experience, such as the possession of a criminal record. He is bound to disclose this even if there was no such question on the proposal form.[126]

It has been realised that the wide-ranging duty of disclosure is too harsh for the proposer. Indeed it has often been said that an insured for insurance may act with perfect good faith to answer the questions on the proposal form and yet not satisfy the duty of disclosure, which the law requires because he did not realise that particular facts were in law material, or did not realise that he had to do any more than truthfully complete the answers to questions on a proposal form. In order to mitigate the harshness of the wide-ranging duty of disclosure, some recommendations for reform in this respect were made by the British Law Commission by producing a working paper in 1979[127] and a final report in 1980.[128] In its working paper the Law Commission expressed the view that the insured's duty should be discharged by truthful answers to questions put by the insurer, and that there was no room for any residual duty of disclosure. However, due to the strong opposition from the insurance industry, this view was abandoned in the final report in 1980. The legal reform has not been undergone so far. Successive governments have accepted "reform" by the way of self-regulation by the insurers themselves. This self-regulation chiefly operates through the principal industry body - the ABI[129] - which frames and adopts voluntary Statements of Insurance Practice that modify the strict law.[130]

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[126] See *Schoolman v Hall* [1951] 1 Lloyd's Rep. 139. As to the residual duty see also *Glicksman v Lancashire and General Assurance Company, Ltd.* [1927] AC 139; and *Taylor v Eagle Star Ins. Co.* (1940) 67 LI. L.R. 136.

[127] See Law Commission. WP No. 70.

[128] See Law Commission. WP No. 104.

[129] See chapter one "Introduction" for the explanation of ABI.

[130] The Statements of Insurance Practice of ABI made in 1977 and revised in 1986, which consist of the Statement of the General Insurance Practice and the Statement of Long Term Insurance. The former was

The Statements of Insurance Practice of ABI was the first device of self-regulation which provided a measure of protection for the individual insureds. They have a significant effect on the insurance law in respect of the doctrine of non-disclosure and misrepresentation which modifies the strict legal rights of insurers to avoid a policy for the insured's breach of the duty of utmost good faith. These statements do reduce the harshness of the wide-ranging duty of disclosure or representation. In the Statement of General Insurance Practice 1(d), it provides "Those matters which insurers have found generally to be material will be the subject of clear questions on proposal forms." In 1(e) it is provided that "So far as is practicable, insurers will avoid asking questions which would require expert knowledge beyond that which the proposer could reasonably be expected to possess or obtain or which would require a value judgement on the part of the proposer." In this area, the IOB[131] - another voluntary mechanism which is a dispute-handling scheme for individual insureds outside the traditional court structure - has an influence as well. As far as the Insurance Ombudsman is concerned, the insurer is under a duty to ask questions on matters commonly found to be material, and any failure to do so will prevent reliance on any alleged failure by the assured to disclose material facts.[132]

There can be no doubt that the Statements of Insurance Practice of the ABI and of the practices of the Insurance Ombudsman have a substantial impact on the way in which the law as to non-disclosure and misrepresentation works in practice. However, legal reform is still needed because the Statements of Insurance Practice of the ABI and the practices of the Ombudsman were just produced for the individual insureds, and those who insure with insurers who are members of ABI, and/or of the IOB. In order to protect the commercial insureds and those who insure with insurers other than members of the ABI and/or of the IOB, reform is still necessary.

The wide-ranging nature of voluntary disclosure has also been adopted in Australian insurance law. The ICA 1984 has a similar provision in section 21(1), it reads: " ...an insured has a duty to disclose to the insurer, before the relevant contract of insurance is entered into, every matter that is known to the insured, being the matter that (a) the

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last revised in 1995 and that on Long Term Insurance in 1986.
[131] See chapter one "Introduction" for the explanation of IOB..
[132] IOB Annual Report for 1991, paras. 2.18 to 2.19.

insured knows to be a matter relevant to the decision of the insurer as to whether or not to accept the risk and, if so, on what terms; or (2) a reasonable person in the circumstances could be expected to know to be a matter so relevant." The reasonable person test of materiality has been held to be produced to soften the harshness of the prudent insurer test.[133] The insured is still in the danger of non-disclosure of material fact simply because voluntary disclosure is too wide and because the idiosyncrasies of individual persons may replace the objective standard of the reasonable person. The insured could disclose everything which he had known and which he knows relevant to the decision of the insurer, and yet much later find that he has still breached the duty of disclosure of "a material fact" which maybe he has never thought material, but which some other person regarded as material.

As in England, so in Australia, the insurance industry has been self-regulated through the General Insurance Code of Practice in order to mitigate the strict law.[134] In section 4.2 headed "proposals", it is provided that insurers shall use proposal forms or have procedures for collecting information in relation to the provision of cover that:

(a) identify all usual information that the insurer ordinarily requires to be disclosed and which the insurer wishes to know prior to providing cover;
(b) clearly inform consumers of their duty of disclosure and the consequences of non-disclosure;
(c) express questions in plain language and, where instructions are necessary, provide information on how the questions are to be answered.

It is clear that voluntary disclosure is not welcome and it has nearly been abandoned in practice although it is still the law in England and Australia.

7.2 The Chinese approach – inquiring disclosure in non-marine insurance

In China, the Insurance Law adopted the way of inquiring disclosure, *i.e.* "asking and answering" the questions in the proposal form. In article 16(1) of the Insurance Law, it is clearly stipulated that "an insurer may raise questions concerning relevant details

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[133] See A.A.Tarr, *The Insurance Contrcts Act revisited,* [1991] ILJ, vol. 4, No.3, pp.216-224.
[134] See the General Insurance Code of Practice of Australia which has been developed by the Insurance Council of Australia Limited.

of the insured subject matter, or of the insured, the proposer shall truthfully disclose such details to the insurer." It appears that the proposer is only obliged to disclose the facts asked by the insurer on the proposal form, while the insurer may not avoid a policy on the ground that the proposer did not disclose something material which is beyond the questions raised on the proposal form even if it is material. In this article it is ambiguous whether or not the insurer may raise questions orally (by telephone or face to face),[135] because it does not expressly stipulate that the inquiry and answer must be done in writing on a proposal form. However, in practice, in China, at present the only way employed to perform the duty of disclosure and representation is answering the questions by the proposer on the proposal form in writing.[136] On some proposal forms, a clause is usually printed on the first page to inform the proposer to answer the questions in writing. It states: "Any information disclosed by the proposer must be in written form, oral disclosure is not effective."[137]

Which way should be adopted (voluntary disclosure or inquiry disclosure) depends on each country's own situation. In a country where the people are well aware of insurance, voluntary disclosure may be more suitable, while in a country where insurance knowledge is not commonly familiar, it is better to adopt the way of inquiring disclosure. It is submitted that at the beginning of the development of the insurance industry in a country, such as in China, inquiring disclosure is more suitable. In my opinion, inquiring disclosure is fairer to the insured and is in agreement with the Chinese situation. Because in China, modern insurance began much later than in England, and China's insurance industry, as mentioned in Chapter two, has developed unevenly, sometimes stopped and sometime rerun, most people do not really know what insurance is, let alone being able to perform the duty of voluntary disclosure. How can they know what facts are material and what facts they need to disclose to the

[135] This problem becomes more and more acute because telephone is commonly used in China now. In England, it is a very common practice to effect policy on car insurance by direct line. It is submitted that the English practice of insurance granted on the telephone will arrive in China in the near future. When taking out insurance on telephone or orally face to face, a record must be made. Personal discussion with Teresa Griffiths, the Assistant General Manager of the China Insurance Co, (UK) Ltd.

[136] Personal discussion with Mrs Zhang Xiaoling, the deputy manager of the Pin An Insurance Company of China, Qingdao Branch; and Mrs Wang Yan, the deputy manager of the International Insurance Business Department of the China Property Insurance Co., Qingdao Branch; and Mr Geng Renwei, the deputy manager of the International Insurance Business Department of the China Property Insurance Co., Qingdao Branch. in August 1998.

[137] See proposal forms of life insurance, personal accident insurance and child safety insurance, etc, of the Ping An Insurance Company of China.

insurer during the negotiation of the insurance contract if there is no questions to be asked by the insurer ? It is sufficient for the proposer to correctly answer the questions put to him on the proposal form. It is beyond the proposer's duty for him to tell the insurer any information outside the scope of the questions.

It is submitted that Chinese insurance law will not adopt the way of voluntary disclosure even when the insurance become more familiar. This is because first, the backgrounds of the emergence and the development of modern insurance in China and England are quite different. In England, in the 16th century, there was no body of men specialising solely in insurance underwriting (*i.e.* no professional insurer or underwriter). A group of merchants would agree to bear each other's risks among themselves, the great bulk of underwriters themselves being merchants. The underwriters and the insureds were the same persons. They possessed quite good knowledge of insurance. So it was suitable to impose a wider duty on the insured then. However, in China, the situation is quite different, modern insurance being introduced from England and other foreign countries in the 19th century, and a number of people do not know insurance well even now. The second reason is that even in England and Australia, the wider duty is regarded as very harsh and has drawn much criticism. Law reform has been recommended regarding the strict rule which is less used today in practice. So it can be concluded that the way of voluntary disclosure will not be employed in China even in the future.[138]

However, some problems need to be noted where the way of inquiring disclosure is adopted.

(1) What question should the insurer avoid asking on the form? For this question, it is suggested: (a) section 1(e) of the ABI Statement of General Insurance Practice should be followed: "Insurers will avoid asking questions which would require expert knowledge beyond that which the proposer could reasonably be expected to possess or obtain or which would require a value judgement on the part of the proposer." (b) to prohibit insurers from kicking the ball to the proposer by asking a general question like this "Is there any other information within your knowledge that is likely to affect

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[138] This situation also applies to foreign insurance companies who are permitted to operate in China. They run their businesses by following Chinese insurance law. See art. 148 of the Insurance Law, it is stipulated: "The establishment of insurance companies with foreign equity or the establishment of

our consideration of this proposal?" Such a question, in fact, sets the proposer in the position of voluntary disclosure. It is therefore suggested that such a general question should be avoided on a proposal form. This can be done through regulation by the Financial Supervision and Control Department – China Insurance Regulatory Commission.

(2) What should the standard of proposal forms be? At the moment, in China, for the motor vehicle insurance, all the insurance companies use the unified proposal forms drafted by the Financial Supervision and Control Department – the China Insurance Regulatory Commission.[139] For other types of insurance, the insurance companies use their own proposal forms, so it is difficult and impossible to set the same standard for different forms. It is suggested, for the proposal forms other than motor vehicle insurance, a similar standard on some main matters can be set by the CIRC, such as questions should be raised in plain Chinese language even a lay man can understand; information on how the questions are to be answered should be provided on the form where instructions are necessary; and clear information should be given to draw the attention of the proposer to the needs to perform his duty of disclosure and truthful representation of material facts and to the consequences of the failure to perform this duty.

(3) Matters which insurers have found generally to be material will be the subject of clear questions on the proposal form. Important questions should be as comprehensive as possible. If there is something important, but it is not included in the proposal form, the insurer can not defend on the ground that the proposer has not disclosed the material fact which decisively influenced him on decision making when the contract is concluded. In a Chinese case this problem was expressly exposed.[140] The proposer effected a fish breeding insurance in 1993. The contract did not include the terms for the species of the fish and the place where they were bred, and the insurer neither

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branches in the PRC by foreign insurance companies shall be governed by this law."

[139] Art. 106 of the Insurance Law provides: "The basic insurance clauses and premium rates for the main types of risk in commercial insurance shall be formulated by the Financial Supervision and Control Department." The law does not require the FSCD to draft proposal forms. However, due the fact that motor insurance is the main type of business in property insurance in China (it accounts for about 70% of the whole property insurance business), the CIRC has recently made unified proposal forms for the motor vehicle insurance for all companies.

[140] Huang Zenghe, *Manyu Baoxian Jiufenan Qianxi Yu Sikao (The Analysis for an Insurance Case of*

raised any question on these matters in the proposal form nor asked any question orally. In fact, the fish were imported from America at a low price. Those fish were more difficult to grow than the local species in the hot weather in south China and so most fish died shortly after the conclusion of the insurance contract. The insurer rejected the claim on the ground that the proposer did not disclose these material facts. The proposer argued that he had no obligation to disclose the facts which the insurer had not asked. The court settled this case through the way of conciliation and required the insurer to pay the proposer 30% of the claim amount and tried to balance the interests of both parties on the reason that both parties had fault, in that the proposer concealed the material fact deliberately, and the insurer did not ask these questions clearly. It must be noted that this case occurred before 1995 then the Insurance Law had not been enacted, and the court made judgement according to article 7 of the Regulations on the Property Insurance Contracts 1983 in which some ambiguity was found. It is submitted that such a case would have been judged for the proposer had it occurred after 1995.

7.3 Voluntary disclosure is required in marine insurance in China

It is interesting that the Maritime Code adopts voluntary disclosure for marine insurance. In article 222 it is provided:

"Before the contract is concluded, the insured shall truthfully inform the insurer of the material circumstances which the insured has knowledge of or ought to have knowledge of in his ordinary business practice and which would influence the insurer in deciding the premium or whether he agrees to insure or not.

The insured need not inform the insurer of the facts which the insurer has known of or the insurer ought to have knowledge of in his ordinary business practice if about which the insurer made no inquiry."

It is not difficult to realise that this article is similar to section 18(1) of MIA 1906 (UK). This is obvious the approach of voluntary disclosure. The reason why the law adopts a different approach in marine insurance and non-marine insurance has been considered earlier. It is suggested that the voluntary disclosure in China adopted in the

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Fish Insurance). Insurance Studies, No. 5, p.53, Beijing, China, 1995.

Maritime Code for marine insurance should be abolished. The reason for this was given above,[141] it is not necessary to repeat it here.

8 Waiver

Waiver means the abandonment of a right by one party, so that afterwards he is estopped from claiming it. Thus in insurance law, an insurer is said to waive the disclosure of any information when he forgoes his right of requiring the proposer to disclose it. The doctrine of non-disclosure of a material fact therefore cannot be used by the insurer to avoid a policy if there is evidence that the insurer has waived the disclosure of such information. The rule of waiver plays a much more significant role in England than in China in handling insurance disputes with respect to non-disclosure. This is due to the difference in the ways of disclosure adopted by England and China. The English way of voluntary disclosure imposes on the proposer a wider duty that he is bound to disclose to the insurer not only the information asked by the questions in the proposal form, but also residual information exclusively within his knowledge which may affect the insurer concerned whether or not to accept the risk and how to fix the premium.

How to determine whether or not the non-disclosed fact is waived by the insurer is not a straightforward question. Although English statutory insurance law does not provide detailed rules relating to waiver, there are some common law rules in this regard. First, the general rule is that omission to ask questions about the risk is not a waiver. Thus the insurer does not waive disclosure of a history of substantial losses by failing to ask for claims experience unless the losses are modest or insignificant.[142] The proposer does not exhaustively discharge his duty of disclosure by merely correctly answering the questions raised by the insurer in the proposal form.[143] There can, however, be situations where by the nature of the questions in the proposal form the insurer can be deemed to have waived the disclosure of certain other information. When a proposer

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[141] See s.4.5 of this Chapter, *supra,* pp. 187-189.
[142] *Marc Rich v Portman* [1996] 1 Lloyd's Rep. 430,433, and [1997] 1 Lloyd's Rep. 225,234.
[143] *Glicksman v Lancashire & Assurance Co.* [1927] A.C. 139; *Schoolman v Hall* [1951] 1 Lloyd's Rep. 139.

is asked a question with reference to a specific time frame, it is generally accepted that the insurer has waived the disclosure of similar information which falls outside such a time frame. Thus, if a motor insurer asks about convictions in the last five years, he waives disclosure of any convictions before that time.[144] Similarly, this is true if the insurer asks questions about some particular things that may amount to waiver of other related things. For example, a health insurer who asks about basic factors, such as age, sex, location, occupation, and smoking habits, but does not require medical tests waives, surely, any material information that the tests would have revealed.[145] Again, in *Roberts v Plaisted* [146] the insurer asked about one kind only of ancillary activity (running a casino) and thus waived disclosure about another kind of ancillary activity that might be conducted on part of the motel premises to be insured against (running a discotheque for non-residents). In this case, in an appeal, Purchas, J. stated: "If the operation of a discotheque was considered to be material at the time when the proposal form was prepared it did not rate as an exceptional risk so as to be included in a supplementary question in the proposal form as did the operation of a casino; once this position was established, it was clearly waived by the questions in that form."[147]

Moreover, any sort of insurer's conduct which misleads the insured into thinking that the insurers intend to continue to insure him can ground waiver. For example, the receipt of a premium due after the discovery of the undisclosed facts will amount to evidence of waiver.[148] In addition, if the proposer leaves a blank to a question on the proposal form which is accepted without any inquiry by the insurer, this will normally be taken as a waiver by the insurer of any duty of disclosure concerning the matters covered by the question.[149] However, the insurer is entitled to avoid the policy if the blank space implies a negative answer which is an incorrect reply to the question in the circumstances.[150] As a short summary of the common law rules to waiver, the test on whether or not information as to facts material to the risk is waived by the insurer appears to be as follows: The proposer must perform his duty of disclosure properly by

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[144] *Jester-Barnes v Licenses & General Insurance Co. Ltd.*, (1934) 49 LI. L. Rep 231, 237 per Mackinnon J (motor).

[145] See Professor Malcolma Clarke, Policies and Perceptions of Insurance - An Introduction to Insurance Law, P.94, Clarendon Press. Oxford, 1997.

[146] *Roberts v Plaisted* [1989] 2 Lloyd's Rep 341 (CA-fire).

[147] *Ibid*, at 347, col.2.

[148] See MacGillivray on Insurance Law, (9th ed.), p. 425, para. 17-86. 1997.

[149] *Roberts v Avon Insurance Co.* [1956] 2 Lloys's Rep. 240.

making a fair presentation of the risk proposed for insurance. If the insurer thereby receives information from the proposer or his agent which, taken on its own or in conjunction with other facts known to them or which they are presumed to know, would naturally prompt a reasonable insurer to make further inquiries, then, if they omit to make an appropriate check or inquiry, assuming it can be made simply, they will be held to have waived disclosure of the material fact which that inquiry would necessarily have revealed.[151]

In China, the rule of waiver has not been considered either by statutory insurance law or by judicial precedents. In practice, however, the rule of waiver seems to be in operation. The Chinese way of inquiring disclosure means that the proposer performs his duty of disclosure by correctly answering the questions raised by the insurer on the proposal form. Other information beyond the questions is deemed to be waived by the insurer. An insurer can never avoid a policy on the ground that the proposer has not disclosed some information outside the scope of the questions on the proposal form. At the moment, in order to obtain more consumers, some insurers even go so far as to waive their right of disclosure by the proposer by deliberately asking fewer or no questions in the proposal form.[152] (This will be discussed later in this chapter under the caption of "The gaps between law and practice in China"). Undoubtedly, disputes relating to waiver of disclosure, although not in evidence at the moment, will sooner or later arise, with the development of the Chinese insurance market. It is therefore suggested that the English common law rules with respect to waiver of disclosure can be invoked when a Chinese court handles similar kinds of disputes. Alternatively, it is suggested that the rule of waiver in relation to the duty of disclosure should be established in China by referring to the English and Australian approaches:

(1) Where an express question in the proposal form asks for some details of certain

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[150] *Ibid.* Properly, though, the grounds for avoidance will be misrepresentation or breach of warranty.

[151] See MacGillivray on Insurance Law, (9th ed.), p.422, 1997,

[152] This point is also raised in England when the insurer asks no questions at all. Unlike the inquiring disclosure in China, the way of voluntary disclosure has been adopted in England, if the insurer asks no questions at all, the court would not so easily decide that the insurer waives disclosure altogether, although it is the Insurance Ombudsman's view that the insurer who asks no questions at all may waive disclosure altogether. Whether this view can be sustained in a court of law may depend on why the insurer did not ask questions. If the reason lies in the way the insurer has chosen to market the cover, there is force in the Insurance Ombudsman's view that the insurer has waived disclosure. See Professor Malcolm Clarke, Policies and Perceptions of Insurance - An Introduction to Insurance Law, p.94,

facts in a specific time frame, it can be deemed that the insurer has waived the disclosure of similar information which falls outside such a time frame. For example, the question in life insurance asking the proposer for details of the illness the life insured has suffered from within the last five years would waive disclosure of illness outside that period even though the insured had previously had a serious disease which might well be a material fact according to the test of materiality.[153]

(2) Where the proposer leaves a blank to a question on the proposal form which is accepted without any inquiry by the insurer, this should be deemed to be a waiver of the disclosure of the information covered by the question.

(3) Where a proposer gives an incomplete or irrelevant answer to a question included in a proposal form about a matter which is then accepted without inquiry by the insurer, the insurer shall be deemed to have waived compliance with the duty of disclosure in relation to the matter.[154]

(4) Where the insurer discovers the proposer's non-disclosure of the material facts before the conclusion of the contract, but he still accepts the application, this can be grounds for waiver of disclosure of that fact.[155]

9. Duration of the Duties

The determination of the date at which the parties' duties to disclose material facts and give true information come to an end is significant for two reasons.[156] Firstly, it fixes the point at which the parties cease to have a duty to disclose the material information to each other. Secondly, after that date, any false information supplied by either party becomes unimportant for the decision of either party as to whether or not to conclude

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Clarendon Press. Oxford. 1997.

[153] See the Life Insurance Proposal Form of Ping An Insurance Company of China where the insurer requires the proposer to disclose the insured's illness history during the last five years. It may be quite logically deducted that the insurer waives the disclosure of the insured's medical history of the years before that.

[154] S. 21(3), the Australian ICA 1984, with some modification by myself.

[155] In the Chinese case discussed above about a rebuilt ship it should be deemed that the insurer has waived the disclosure of the material fact that the ship was rebuilt from an old ship, because he knew the proposer concealed this, but he accepted the insurance without raising any inquiry about this.

[156] In nearly all the books in relation to insurance law, when the time of disclosure is discussed, the emphasis of the analysis is put on the insured's duty, *i.e.* when the insured's duty of disclosure and representation comes to an end. I would personally submit that both parties' duties should be considered because the principle of the utmost good faith applies to the insured as well as to the insurer.

an insurance contract with the other. Under this topic, two aspects need to be discussed, there are the pre-contractual duty and the post-contractual duty of disclosure. They will be examined separately.

9.1 Disclosure before formation, renewal and the restoration of the contract

Before the conclusion of a contract of insurance, the purpose of disclosure of the material information by both parties is to supply information which the parties may rely on to make their decision on whether or not they will conclude the contract with each other. The purpose of disclosure of material facts by the proposer is to enable the insurer to decide whether to take the risk which the proposer is seeking cover for, and if so, on what terms. As to the insurer's duty of disclosure,[157] the purpose is to tell the proposer some important information about the insurance contract which the insurer knows well but the proposer does not, in order that the proposer can decide if he will take out that particular insurance with the insurer. Thus the duty of disclosure for both parties primarily applies to negotiations preceding the formation of the contract. So in China, England or Australia, the duty of disclosure comes to an end at the date at which the contract is concluded.[158] In the case of a new insurance contract, the duty matures when the contract is concluded. If the policy is a short-term policy that is subject to renewal, then every renewal is a fresh contract and the duty of disclosure must be complied with prior to every such renewal. It seems there is no difference in views for this point in Chinese, English or Australian insurance law and practice.

In China, under the duty of inquiring disclosure, the proposer's obligation of utmost good faith is to answer the questions in the proposal form honestly and correctly. In general, this duty comes to an end when the proposal form is completed, but it could be thought that the proposer may withdraw an incorrect statement made on the proposal form and give an accurate one before the insurer's acceptance of the proposer's application. The proposer should disclose the change of the circumstance, if any,

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[157] Arts. 16 and 17 of the Insurance Law require the insurer to explain, when the contract is formed, the details of the terms and conditions of such a contract, especially the exceptions of the contract. S.17 of the MIA 1906 (UK) provides that the principle of utmost good faith must be observed by either party. See also s.22 of the ICA 1984 (Australia).

[158] See art. 16 of the Insurance Law; and s.18(1) of the MIA 1906 (UK) and s.21(1) of the ICA 1984 (Australia).

between the application of the proposer and the acceptance of the insurer. If the contract is conditional on the first payment of the premium, the duty lasts until the time of the payment of the premium.

In England, according to the MIA 1906, the assured must disclose to the insurer, before the contract is concluded, every material circumstance which is known to the assured, and the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him.[159] Common law also illustrates that the duty of disclosure of the material facts is cast upon the proposer only before the contract is concluded, and as the renewal of most non-life policies constitutes the creation of a fresh contract, the duty of disclosure arises on each successive renewal.[160] In practice, the duty of disclosure for a renewal requires the insured to disclose any occurrence material to the risk which has happened since the inception of the expiring risk, and of which the insurer is ignorant.[161]

Subject to the test of materiality of non-disclosure, it can also be inferred that the proposer has to disclose material facts before the conclusion of the contract, because this information will be taken by the insurer as basis for his decision on whether he will provide the cover or raise the premium rate.[162] After the conclusion of the contract, such information becomes immaterial as it cannot affect the insurer's mind as to whether or not to take the risk or charge more premium.

Another interesting question worthy to be discussed here is whether the duty of disclosure is required when a suspended life policy is restored. This question has not been dealt with by law either in China, England or Australia and no comment has been found in these countries, but only a few writers have commentated on this question in

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[159] In s.18 (1) of the MIA 1906, captioned as "Disclosure by assured", the matters of assured duty, *inter alia*, the time of disclosure by the assured are provided. It is submitted that if there had been a separate caption for the insurer's duty, the time of disclosure by the insurer would have been the same as that when the insured's duty came to an end. So it is not necessary to discuss the time of disclosure by the insurer separately.

[160] *Lambert v. Co-operative Ins. Soc.* [1975] 1 Lloyd's Rep. 465.

[161] See MacGillivray on Insurance Law, p. 398, para. 17-21, (9th ed.), 1997.

[162] See s.18 (2) of the MIA 1906 (UK) and article 16 of the Insurance Law. See also s.21(1)(a) of the ICA 1984 (Australia): "the insured knows to be a matter relevant to the decision of the insurer whether to accept the risk and , if so, on what terms."

Taiwan.[163] By virtue of articles 57 and 58 of the Insurance Law (PRC), in a long-term life insurance, the proposer may pay the premium by instalments. The contract shall be suspended if the proposer fails to pay the instalment within 60 days. However, where the insurer and the proposer reach an agreement through consultation, and the proposer has made up the premium in arrears, the suspended contract shall be restored. Where the parties fail to reach an agreement within two years from the date of suspension of such a contract, the insurer shall have the right to rescind the contract. It is submitted that, during the consultation of the matter on the restoration of the contract, the duty of disclosure by the proposer arises in order to prevent the proposer's "adverse selection". Because, as a matter of practice, where the proposer decides to apply for a restoration of the life policy, in most cases the life insured's condition of health is not very good.

9.2 Disclosure during the currency of the contract

As was noted above, it is beyond dispute today on the point that the parties have a pre-contractual duty of disclosure and truthful representation to each other during the negotiation for the conclusion of an insurance contract or renewal of the contract, and there are no different views that such a duty terminates when the contract is formed. At this stage the question whether or not the requirement of the utmost good faith also applies throughout the contract will be discussed. For this question, the Chinese Insurance Law gives a positive answer for property insurance[164] but, it is not stipulated in the Insurance Law for life insurance. In England and Australia, this question is not clear-cut positive or negative.

In China, by article 36 of the Insurance Law, it is obvious that the insured has a continuing duty of utmost good faith. However, it seems that the law only imposes the continuing duty on the proposer in property insurance[165] because article 36 is under the head of "Property Insurance Contract". Article 36 deals with matters of the insured's

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[163] See Lin Xunfa, The Validity of Insurance Contract, p.259, 1996, Taipei, Taiwan. He comments that the proposer should have the duty of disclosure when the suspended life policy is restored. See also Jiang Zhaoguo, The Basic Theory of the Insurance Law, p.158, 1995. He has the opposite view.

[164] See art. 36 of the Insurance Law, in which, the insured is asked to notify the insurer where the risk of the subject matter of insurance increases; and art. 27 stipulates that the insured or beneficiary can not make a fraudulent claim.

[165] Property insurance business, defined by art. 91 of the Insurance Law, includes insurance business such as loss of property insurance, liability insurance, credit insurance, etc;

duty of notification of the increase of risk during the currency of the policy. It provides: "Where the degree of risk of the subject matter of insurance increases during the term of a contract, the insured shall notify the insurer in a timely manner in accordance with the contract and the insurer shall have the right to demand an increase in the premium or rescind the contract." According to this article, there are at least four aspects of matters being involved:

(1) The law imposes on the insured a continuing duty of utmost good faith after the conclusion of the contract;

(2) During the term of the contract, the insured has a duty of notification only when the degree of the risk covered is increased;[166]

(3) The continuing duty shall be performed by the insured in accordance with the agreement of the policy;[167]

(4) The insurer has right to increase the premium for the increased risk or alternatively to terminate the contract after being notified by the insured.

A number of questions may arise from this article:

(1) To what information does the continuing duty relates? This question, in theory, seems not difficult to answer. It is clearly not the information which may influence the insurer's decision on whether or not to supply the cover and how to fix the premium, because the insured's duties as to those information terminates when the contract is formed. The information which the insured is required to notify to the insurer after the inception of the policy is the information that may affect the insurer's decision on whether he will charge a higher premium upon an increase of risk or

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[166] In art. 37, it is stated: "Unless a contract provides otherwise, the insurer shall reduce the premium and refund the corresponding premium calculated on a daily basis under any of the following circumstances: (1) the degree of risk of the subject matter of insurance has decreased remarkably as a result of the changes to the circumstances under which the premium rate was determined: or (2) the value of the subject matter of insurance has decreased remarkably." According to this article, it seems that the insured should also inform the insurer where the covered risk decreases (because only when the insured notifies the insurer, will he know that one or both of the two situations exist, and reduce or refund the premium to the insured) but it is essentially different from the notification of the increase of risk stipulated in art. 36. The notification of the increase of risk is a duty imposed by law on the insured, and by breaching it the insured must bear the legal consequence. The notification of the decrease of risk by the insured is just for the purpose of recovering the corresponding premium to the decreased risk, a failure to do so is not a breach of duty, and it just means that the insured waives his right to claim the premium.

[167] In China, not all insurance policies provide the insured's duty of notification for the increase of risk. For example, the comprehensive property insurance policy and the policy of basic cover property insurance have provided that the insured has duty to notify the insurer in the event of the increase of the risk insured against. However, in the policy of household insurance, no such term is provided.

whether he wants to terminate the contract due to the increased risk. The problem is that it is difficult to set up a standard on what degree of the increase of risk may cause the insurer to increase premium or terminate the contract. A Chinese scholar gives some examples for the increase of the risk, he said: "During the currency of the contract, several cases may cause the risk to be increased, for instance, the usage of the insured property has changed, *e.g.* a building changed from dwelling to business purpose, or from an office to a workshop, such changes should be notified to the insurer in a timely manner."[168] It is submitted that it is not easy for an ordinary insured to know what kind of change should be disclosed to the insurer. As was discussed earlier, for the pre-contractual duty, the proposer may perform his duty by truthfully answering the questions asked by the insurer, but, for the post-contractual duty, no question is asked by the insurer, how can an ordinary insured know what kind of alteration of the risk is needed to inform the insurer? Under this circumstance, it could be suggested that if an insurer wishes to be notified of the increases in risk, he must expressly stipulate in the policy what kind of information or what extent of the increase of risk he needs to be notified by the insured.

(2) What is the test of the materiality in the post-contractual duty of disclosure? As was discussed above, in China, as to the pre-contractual duty, the test of materiality was determined as the prudent insurer's decisive influence test, *i.e.* a non-disclosed fact is material where it can change the insurer's mind on whether or not to take the risk or on fixing the premium if he had known the fact. Accordingly, the post-contractual duty test should be defined as that an information is material if it can cause a prudent insurer to increase the premium or alternatively to terminate the policy. Assuming that the prudent insurer decisive influence test is taken to examine the materiality for an un-notified piece of information for a continuing duty of utmost good faith, it seems that not all the increase of risks should be notified but only those which can cause the insurer to increase the premium or to terminate the contract alternatively.[169] The burden of proof is still on the insurer, *i.e.* he must prove an increased risk is sufficient

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[168] See Zhou Yongsheng, Baoxian Yu Falu (Insurance and Law), p. 77, 1998.

[169] On this question, a Chinese writer expresses his view, he says: "after the conclusion of a property insurance, the insured should notify the insurer of any increased risk if the increased risk would be sufficient to influence an insurer's decision on whether or not he would supply the insurance or what premium he would charge at the time when the contract was concluded." See Wang Baoshu, Zhongguo Shangshifa (Chinese Commercial Law), p.510, People's Court Press, 1996.

to cause a higher premium or he would terminate the policy altogether.

(3) What are the consequences for a failure to act with a continuing duty of utmost good faith? Namely, the issue arises whether the "avoidance" for a post-contractual non-disclosure operates *ab initio* and therefore retrospectively. If it applies, it would, for example, prevent the insured from recovering a previously unsettled claim under the policy which occurred before the risk was increased. This legal consequence seems too rigorous to the insured who performed the pre-contractual duty honestly but failed to perform the post-contractual duty of notification of the increase of risk.[170] For the consequence of the breach of continuing duty, the English Judge Hirst J's view is considered here. In the case of *The Litsion Pride,* he pointed out (assuming that the section 17 of the MIA implies a broader duty) that, "although 'avoidance' in section 17 of the MIA 1906 meant avoidance *ab initio,* section 17 provided that the policy *may* be avoided, not that it *must* be avoided and here in the case of post-contract breach it was open to the underwriters simply to defend the claim without avoiding the policy."[171] Later developments, to be discussed below, make it very unlikely that, for post-contract non-disclosure avoidance *ab initio* will be allowed.

In China, a breach of a duty of notification of the increase of risk enables an insurer under the Insurance Law, to repudiate liability for the loss or damage caused only by the increased risk,[172] but not to avoid the contract entirely. This provision implies that the insurer has an obligation to pay the insured for the loss or damage of the subject matter of insurance which is not caused by the increased risk. For example, a lorry was insured on the condition of carrying coal and it was later changed to carry fire works, but the insured did not notify the insurer of this change, so the insurer is held to

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[170] In most cases, it made no practical difference to the position of the insured in the case whether the policy as a whole or just the increase of risk was the subject of the avoidance, for insurance, where no loss or damage had occurred before the increase of risk.

[171] *Black King Shipping Corporation and Wayang v Mark Ranald Massie, The Litsion Pride,* [1985] 1 Lloyd's Rep, 437, at p. 515, col.2. However, the remedy for breach of continuing duty of utmost good faith, in England, is still a point at issue. The answer is still awaited on whether the remedy of avoidance is confined to avoidance for making a fraudulent claim and operates only with effect from the time of fraud or retrospectively *ab initio.* This will be crucial where there have been previous (honest) claims under the policy. In the recent case *Manifest Shipping & Co. Ltd. v. Uni-Polaris Insurance Co. Ltd. (The "Star Sear")* [2001] 2 W.L.R. 170 it was held that it is disproportionate for the insurer to be able to avoid an insurance contract *ab initio* for a post-contract non-disclosure by the insured. This will be discussed soon.

[172] Art. 36(2) of the Insurance Law.

be liable to indemnify the insured where the loss or damage of the subject matter of insurance was not caused by the explosion of fire works, for instance, if the lorry ran into another vehicle, and the fire works were not thrown out although they are loaded on the lorry, but, if the lorry run into another vehicle which caused the explosion of the fire works and finally destroyed the lorry, the insurer is not liable to indemnify the insured.[173]

However, it is uncertain under article 36 whether the increase of risk refers to permanent increase or occasional increase. It is submitted that the increase of risk should be divided into permanent increase and occasional increase. For a permanent increase of risk, such as where the risk changes in nature, the insurer may terminate the contract, when the insured breaches his duty of notification, from the time when the risk was increased, or he may repudiate liability, but not avoid it *ab inito*. Thus, the insured may recover from the insurer for the loss or damage, if any, which occurred before the increase of risk. For occasional increase of risk, the insurer may not terminate the contract, but may repudiate the liability for the loss or damage that was caused by the increased risk.

In my opinion, the provision of the duty of notification of the increase of risk is fair to the insurer and not unfair to the insured. The insurer may increase the premium or terminate the contract for the increase of risk after being notified by the insured, otherwise he would bear the higher risk on the lower premium. It also may reduce the chance of some insureds who wish to obtain better coverage by paying lower premium.

As far as life insurance and personal accident insurance are concerned, the Insurance Law does not provides whether an insured has a continuing duty to notify the insurer where the insured risk increases. It is submitted that the law should impose a duty on the insured to give a notification to the insurer where the insured changes his occupation to a higher risk occupation. For example, if a man effected a personal accident policy when he was a teacher, he might become a policeman or a builder

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[173] In China, a vehicle is often fully used to carry different things. Especially in the case of an individual business, in order to make more profit, the owner often uses his lorry as much as he can to carry both coal and fireworks or other things; while in England, some vehicles are designed for a special purpose. For instance, some lorries for carrying coal have an automatic unloading device. The coal-carrying vehicles are rarely, if ever, used for carrying fireworks, but that would not be unusual in China.

afterward during the currency of the policy. The risk of his latter occupation is obviously higher. The change of his occupation is a material fact which would enable the insurer to increase the premium if he has been notified. However, it is suggested, if the Law would impose such a duty on the insured, the insurer's right should be limited to increase the premium for the increased risk but not to cancel the policy. The reason is, for a long term policy, if an insured person takes up a new occupation which that insurer would not cover, but it is not fair to allow the insurer to withdraw cover, because the insured will be older and may find it harder to find an insurer who does accept that occupation especially if the insured has to disclose the cancellation of the policy. Personal accident insurance is usually renewable, if the insured changes his occupation to another one during the currency of policy, the insurer may charge higher premium if the risk increases or may refuses to renew the policy when the existing policy expires if the insurer would not cover the insured's new occupation. It is noted that some personal accident insurance policies provide that "during the currency of the policy, if the insured changes his occupation notice should be given to the insurer and the insurer will endorse the policy if he agrees."[174] However, the clause does not provide what step the insurer would take where he is notified, and what the consequence will be if the insured fails to notify him. It is suggested that if the insured takes up a higher risk occupation the premium should be increased, while if the insured's new occupation is a lower risk occupation than the previous one, the insurer should decrease the premium correspondingly. The remedy for the insured's failure of notification for his higher risk new occupation, the insurer should be allowed to refuse liability if the occurrence of the insured event is caused by or as a result of the increased risk.

In England, there is no continuing duty of disclosure in life insurance or accident insurance. For property insurance, the general rule is that the duty of disclosure and representation by the insured comes to an end at the time when the contract is concluded which is supported by the statute of the MIA 1906, ss.18(1) and 20(6). The Act did not provide the requirement for the insured to disclose material facts or notify the increase of risk to the insurer after the formation of the contract, and in common law, there is in general no such duty. Several cases may illustrate this. In the old

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[174] See clause 5(6) of the Personal Accident Insurance Clauses of Ping An Insurance Company of China.

leading case *Pim v. Reid,*[175] the insured changed his trade during the currency of the contract and caused a large amount of highly inflammable material to be brought on to the insured premises. The insurance was on machinery in a mill. When the policy was effected the mill was being used for the manufacture of paper, but during the currency of the policy the insured started the business of a cleaner and dyer of cotton waste, which involved a use of a more hazardous sort, and a loss occurred. It was held that the non-disclosure of the alteration of risk to the insurer was not actionable. In the absence of any express condition prohibiting alterations in use, and in the absence of the alteration contravening any description of the subject-matter of the insurance, the change of the trade did not invalidate the policy. A similar conclusion was reached in another case, *Shaw v. Robberds.*[176] In this case, a fire policy was effected in respect of a kiln, which was to be used only for drying corn. On one occasion, the insured allowed a third party to dry bark in the kiln and this occasioned a fire which brought about the dispute. It was held that the insurer were liable, in the absence of any warranty to the effect that the kiln was to be used only for drying corn. There was nothing in the common law to prevent a more hazardous use being undertaken. Following the MIA 1906 and these cases, it is clear that the insured is not under a continuing duty of utmost good faith relating to increase of risk. This was confirmed by some recent cases of *New Hampshire Insurance Co v. MGN Ltd.*[177] and of *Kausar v. Eagle Star Insurance Co Ltd.*[178]

However, there are some exceptions from this principle, namely, where the policy expressly provides for the case in which the risk is increased, where the risk changes in

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[175] (1843) 6 M. & G.1.
[176] (1837) 6 A. & E. 75.
[177] [1996] C.L.C. 1692, at p.1694. In *New Hampshire,* the Court of Appeal rejected the argument that the insured is under a duty to disclose to the insurers facts material to the exercise of the right of cancellation and is therefore under a continuing duty to disclose facts during the currency of the contract. It was held that "An assured was not under a continuing duty to disclose material facts throughout the period of insurance merely because of the insurer's right to cancel."
[178] [1997] C.L.C. 129. It was held that a provision which stated: "You must tell us of any change of circumstances which increases the risk of injury or damage and you will not be insured under the policy until we have agreed in writing to accept the increased risk", has been ineffective when, in an insurance of a shop, the insured failed to tell the insurers that threats to damage the shop had been made by the tenants and (unlawful) sub-tenants. The result may be justifiable on the ground that this was not in any event a permanent increase in risk. This decision confirmed the common law position that there is no duty of continuing utmost good faith and disclosure on an insured, except in so far as there is a duty at the claims stage, especially not to make a fraudulent claim.

nature rather than merely increases in a limited way[179] and, in the context of marine voyage policies, where the vessel deviates, delays or changes its voyage.[180]

The possible existence of a continuing duty of utmost good faith was discussed by Hirst J. in the case of *Black King Shipping Corporation v. Massie, The Litsion Pride,*[181] which is worth discussing here. In this case, the ship, the *Litsion Pride*, had been covered by the defendant. The insured was asked, by the policy, to give notice to the insurer as soon as practicable in the event of ship entering into the specified areas, for the most part war zones - the more hazardous areas attracting additional premium. On 2nd August 1982 the ship entered the war zone during the Iran-Iraq war. On 9th August she was attacked by an Iraqi helicopter and struck by a missile. On 11th August 1982 the owners' brokers received a telex from the owners stating that a letter informing the brokers of the imminent entry of the ship into a war zone had been written on 2nd August but by oversight not sent; that letter, dated 2nd August 1982, was received by the brokers on 12th August, and was submitted to the insurer. A claim made by mortgagees of the ship was refused by the insurer on the ground of the owners' fraud and breach of duty of utmost good faith in failing to notify, in accordance with the policy, an increase in the risk. The judgement was made for the insurer on the ground of the fraudulent claim by the insured. It was held that the duty of utmost good faith extended to claims, and any fraudulent statement which would influence a prudent underwriter's decision to accept, reject or compromise the claim was material. The insurer could avoid the whole contract or reject the claim.[182] Despite having disposed of this case on the basis of fraud, the learned judge, considered an alternative defence pleaded by the defendant that the insured had been in breach of their continuing duty of utmost good faith, *i.e.* the insured failed to notify of the insurer the increase of risk when the insured ship went into a war zone which was asked to be notified to the insurer.[183] According to the alternative approach set out by

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[179] See the case of *Hadenfayre Ltd v British National Insurance Ltd* [1984] 2 Lloyd's Rep 393.
[180] MIA 1906, ss.45 to 49;
[181] [1985] 1 Lloyd's Rep. 437.
[182] The approach adopted by Hirst J in *The Litsion Pride* was confirmed by Evans J in *Continental Illinois National Bank of Chicago v. Alliance Assurance Co Ltd, The Captain Panagos.* [1986] 2 Lloyd's Rep.470. In this case, the judge upheld the insurer's right in rejecting a fraudulent claim made by the insured.
[183] *Ibid.*, p. 512, col. 1. Hirst J. said in this case: "consequently, I hold that the duty of utmost good faith applied with its full rigour in relation to the giving of information of the voyage under the warranty; the insured was required, in accordance with commercial good sense, to notify any relevant information

Hirst J., it is clear that the insured has a continuing duty of utmost good faith and the duty applies throughout the whole contract, including the claim process.

The more recent case of *Manifest Shipping & Co. Ltd. v. Uni-Polaris Insurance Co. Ltd. (The "Star Sea")*[184] developed a number of new rules relating to the continuing duty of utmost good faith. It was held: (1) During the currency of the policy, when the contract is being varied, facts must be disclosed which are material to the *additional risk* being accepted by the variation. It is not necessary to disclose facts occurring, or discovered, since the original risk was accepted material to the acceptance and rating of that risk; (2) Since there was a distinction between lack of good faith which was material to the making of an insurance contract and lack of good faith during the performance of the contract, different obligations were involved at pre-contract and post-contract stages; (3) While in the pre-contract stage there was a positive duty to disclose all information which was material to the risk proposed and the assessment of the premium, it would be disproportionate for the insurer to be able to avoid the contract *ab initio* by reason of the post-contract failure of the assured to reveal all facts which the insurer might have an interest in knowing and which might affect his conduct; (4) When a claim was being made under the policy the duty was one of honesty and required that the claim was not made fraudulently; (5) Once the parties were engaged in litigation the rationale for the duty of good faith no longer applied because the parties were governed by the rules of court and, consequently, the duty was superseded by the rules of litigation

In Australia, the position of law is similar to that of England. The duty of disclosure

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available from time to time particularly since this was a field where during the course of a voyage ETA destination, etc., were quite likely to change as it proceeded; and the duty of utmost good faith extended to claims".

[184] [1997] 1 Lloyd's Rep. 360. In this case, the insured effected the policy in 1989 for over 30 vessels, one of which was the Star Sea. The vessel was destroyed by a fire started in a engine room and was pronounced a constructive total loss. The insured claimed on the insurance policy. The insurer refused to meet the insured's claim on the grounds that (i) she was unseaworthy because her captain and crew were incompetent and the engine room dampers were faulty, the owners had been privy to that unseaworthiness by virtue of "blind eye" knowledge and consequently the insurers were not liable for the loss pursuant to s.39(5) of the MIA 1906 and (ii) the owners were in breach of their duty to observe the utmost good faith pursuant to s.17 of the Act in that, there had been a failure to disclose material information by, *inter alia*, claiming legal privilege for reports into one of the earlier fires, failing to disclose them until privilege was waived on the second day of the trial, and that consequently the insurers were entitled to avoid the contract. Both defences of the insurers were rejected on appeal, the insured was allowed to recover the full value of the vessel. See [2001] 2 W.L.R. 170 for the details of

does not extend beyond the date on which the contract of insurance is concluded. This common law position is embodied in section 21(1) of the ICA 1984 (Australia). The doctrine of the utmost good faith cannot be invoked to extend the duty of disclosure beyond that time by virtue of section 12 of the Act under which it is made clear that the duty of the utmost good faith does not extend the duty of disclosure beyond its limits as delineated by common law and the Act. Hence, once the contract has been made, a mere change in the hazard of the risk does not affect the liability of the insurer. The only exceptions are that (1) where the terms of the policy require information to be given to the insurer in certain events, in which case good faith in supplying that information is required;[185] and (2) where a change in conditions means that the nature of the risk altered so that the insured is subject to a risk which is not the risk insured against.[186]

If there is a breach of the policy by the insured with the result that the liability of the insurer can be avoided, section 54 of the ICA 1984 comes into play to relieve the insured of the consequences of such a breach. Section 54 has the effect of converting the remedy of the insurer into a cross-claim or equitable set-off for damages for breach of contract, *i.e.* the insurer may not refuse to pay the claim by reason only of that act but his liability in respect of the claim is reduced by the amount that fairly represents the extent to which the insurer's interests were prejudiced as a result of that act. This section also imposes a concept of causation, namely, where the act or an omission of an insured or of some other person is causative of the loss in the sense that it could reasonably be regarded as being capable of causing or contributing to the loss, the insurer may refuse to pay the claim.[187] However, there are some qualifications to this general proposition: (1) this consequence will not eventuate if the insured proves that no part of the loss was caused by the insured's act or omission in which case the insurer cannot refuse to pay the claim.[188] (2) if the insured proves that there was no causation as to some part of the loss the insurer may not refuse to pay that part of the

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the decision of the Cour of Appeal.

[185] See *The Litsion Pride* [1985] 1 Lloyd's Rep. 437.

[186] See *Workers' Compensation Commission (N.S.W.) v. National Employers Mutual General Insurance Assoc. Ltd* (1978) 141 C.L.R. 462.

[187] S.54(2) of the ICA 1984 (Australia).

[188] *Ibid.* s.54(3).

claim.[189]

In summary, the Insurance Law expressly imposes the obligation on the insured to give notice to the insurer where there is an increase of the risk of the subject-matter of the insurance in non-life insurance, while the English law and the Australian law generally do not impose such a duty on the insured. However, it is not difficult to realise that, in essence, the three countries' approaches do not conflict with each other. Article 36 of the Insurance Law has two features in respect of requirement: (1) by implication, it does not require the insured to notify any increase of the risk, but that which may enable the insurer to raise premium or terminate the contract and which must refer to the temporary or permanent alteration of the risk in nature; (2) it provides that where the risk increases, the insured shall notify the insurer in accordance with the agreement of the contract. These two features, essentially, are the exceptions of the general rule in England and Australia that there is generally no continuing duty of disclosure. Because in England and Australia the laws do not require the insured to give a notification where the insured risk increases but is subject to the exceptions: (i) where the notification is expressly required to be given in the policy; (ii) where the alteration is in the nature of the risk. It could be concluded that the duty of disclosure continues after the conclusion of the contract only in some certain situations mentioned above.

As far as the consequences for the breach of the duty are concerned, in both China and Australia, the laws employ the concept of causation, namely, where the loss is caused by the increased risk, the insurer is not liable. It is submitted that this remedy is fair and acceptable.

10. Material Facts

As the materiality or otherwise of a particular piece of information is a question of fact, something which is regarded as material in one case cannot, *ipso facto,* be regarded as material in all subsequent cases. The materiality of a particular fact has to be determined within the context of the case itself. So it is difficult or impossible to

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[189] *Ibid.* s.54(4).

formulate some unified standard by statutory law to test what facts are material facts in all circumstances. In England and Australia, in case law, case-decisions on the materiality of particular facts can therefore be regarded only as guidelines in subsequent cases. In China, due to the fact that the duty of disclosure is performed by the proposer by answering the questions on proposal forms, the questions in the proposal form are normally regarded only as the scope of the material information. In practice, facts regarded as material have traditionally been classified into two broad categories, facts relating to physical hazards and facts relating to moral hazards. It is appropriate to consider them separately.

10.1 Physical hazards

Physical hazards are determined by the physical condition and nature of the subject matter of insurance and the scope of the insurance.

In England, there is a large body of case law dealing with the materiality of particular facts relating to different contexts of insurance. In China, there are only a few cases. Considered below are some of the physical hazards recognised in some different main branches of insurance in China, and they are also the questions most frequently raised in proposal forms. Occasionally, some English cases will be involved at this stage.

(1) Life Insurance:

(a) Age:

In life insurance, the life insured's age is material since it affects his life expectancy, and so it directly influences the insurer's decision either in accepting the risk or in determining the premium. So the Insurance Law requires the proposer to disclose the true age of the insured,[190] and questions in relation to age of the life insured are almost always raised in proposal forms in life insurance. Also in some insurance policies, the age of the life insured is strictly restricted when the policy is effected. For instance, a clause of the life insurance of the Pingan Insurance Company of China stipulates that the insured who is covered under the life insurance policy should be within the age

[190] Art. 53 of the Insurance Law.

limit of 16 to 65 when the contract is concluded. If he is beyond this limit when the contract is concluded, the insurer will not supply the coverage to him.[191] So when making a life insurance contract, the proposer must tell the insurer the true age of the insured. A failure to do so may result in two consequences according to the Insurance Law. Where the declared age of the life insured is not true, but his true age meets the age requirement set forth in the contract, the Insurance Law does not allow the insurer to avoid the contract, instead the Law provides a formula for adjusting the premium once the true age is known.[192] Where the age of the insured as declared by the proposer is not true and his true age fails to meet the age requirement set forth in the contract, the insurer is entitled to avoid the contract on the ground of non-disclosure or misrepresentation.[193] For example, a company took out industrial life insurance for its employees, and a worker was declared to be aged 62, but his true age was 64 when the contract was concluded. The insurer may not avoid the contract; instead, he may adjust the premium paid to make up the payable amount. However, if the declared age of the insured was 62, and he was in fact 66, older than the top limit of the age of 65, the insurer would then have the right to rescind the contract.

However, an "indisputable" clause renders the rule of non-disclosure or misrepresentation not wholly applicable even in the latter situation. As was noted above, where the age of the insured is wrongly declared and his true age is outside the limitation of the age set forth in the policy, the insurer has the right to rescind the contract, but the insurer's right will be restricted by an exception, that is, if the contract has lasted for two years or more since the date of conclusion, the policy will become an indisputable document which can not be rescinded by the insurer on the ground that the proposer misstated the age of the life insured when the contract was concluded.[194] Let us take the above example, the insured was aged 66, but he was wrongly stated as being 62 by the proposer when the contract was concluded, if the misrepresentation was discovered within two years after the formation of the contract, the insurer is

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[191] It does not mean that the insurance coverage will cease when the insured become 65. The age of the insured is limited only at the time when the contract is concluded, *i.e.* if an insured is within the age limit set up by the policy when the contract is concluded, for example 50 years old, the cover will continue when he becomes 65 or more. The insurers do not like to insure old people, because the older the age, the higher the risk, so the insurers set up a limitation for the insured age at the time when the contract is concluded.

[192] Art. 53(2) &(3) of the Insurance Law.

[193] Art. 53(1) of the Insurance Law.

entitled to rescind the contract, but if it was discovered more than two years after the conclusion of the contract, the insurer can not rescind the contract according to the indisputable clause. The intention of this provision is to protect the insured and beneficiary and to prevent the insurer from abusing his right. Life insurance is a long term policy, and so if the insurer avoids the contract or refuses liability (assuming the insured event occurs) many years after the conclusion of the contract, the insured or beneficiaries who are innocent parties will suffer a serious financial loss. However, the law fails to stipulate that how the insurer will make payment to the proposer or beneficiary where the benefits payable to someone overage are not available. It is suggested that, under this circumstance, the insurer may reduce the payment of the insurance moneys corresponding to the premium the proposer actually paid.

(b) State of health:

The insured's state of health is clearly a material fact for a life insurance policy, since it will help the insurer to draw a conclusion about his life expectancy. If the insured has ever had a disease or is suffering from any disease when the contract is concluded, the proposer should disclose such facts to the insurer. Otherwise the insurer has the right to avoid the contract. The Insurance Law does not deal with this aspect, but in practice this is regarded as a material fact when making a life insurance contract and questions in relation to the insured's state of health always appear on the proposal form. In some life insurance policies, it clearly stipulates that people who are suffering from serious disease may not effect a life insurance policy. This is illustrated by a Chinese case, *A Beneficiary v. Guangzhou Insurance Company*.[195] The insured effected an industrial life policy with Guangzhou Insurance Company. Before and at the time the policy was effected, the insured failed to disclose to the insurer that he had suffered from heart disease which caused him to stay in hospital for treatment where he had a pace-maker installed in his heart some time 4 years before he effected the policy. When the insured died from the heart disease a few months later, the insured's beneficiary made a claim under the policy, but the insurer refused liability on the grounds of the non-disclosure of the insured's heart disease, because the proposal form clearly stated that people who were suffering from the serious heart problem could not effect such a

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[194] Art. 53(1) of the Insurance Law.

[195] Hu Wenfu, Baoxian Lipei Suopei Zhinan (The guidance of claim settlement) p.51 Procuratorate Press of China, 1993.

policy. The beneficiary took action against the insurance company arguing that the insured had suffered from the heart disease 4 years before he effected the policy and he had recovered and was able to work when he took out the insurance, so the insured's heart problem should not be regarded as a serious problem, and the insurer should be liable to pay the insurance money. The defendant contended that the insured had had a pace-maker installed, which was regarded as being a serious heart disease. The point at issue was what was a serious heart disease? The medical expert's opinion was that the insured's own heart could not start normally, needing a pace-maker to help, and that such degree of heart problem should be regarded as a serious disease. So the court made judgement for the insurer.

It is not every trivial illness that will call for disclosure. In order to let the proposer know what health problems need to be disclosed, in China most life insurance proposal forms list some diseases which need to be disclosed by the proposer.[196] The state of health of the assured's close relatives is not required to be disclosed in China but it is regarded as a material fact in England.[197]

(2) Property Insurance:

In property insurance, what facts can be regarded as physical hazards depends upon the type of property insured, and the risks being covered by the policy. For example, the most important facts for premises which are being covered under a fire policy are the materials which were used to build the premises,[198] and the type of the premises (detached or semi-detached). For the storage fire insurance, the material facts are the natures of the stored goods, *i.e.* whether or not they are flammable material or inflammable material. Similarly, different types of insurance for the same subject

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[196] For example, in the life insurance proposal form of the Pingan Insurance Company of China, a question is asked by the insurer as to whether or not the insured has had the following diseases within the past five years: (1) Hypertension, heart disease, blood vessel disease, and cardiovascular disease; (2) epilepsy, mental disease, brain disease; (3) tuberculosis, asthma, bronchitis, pneumonia; (4) digestive inflammation, ulcer and bleeding , pancreatitis, hepatitis, fatty liver, hepatocirrhosis; (5) nephrosis, venereal disease, disease of the genito-urinay system; (6) diabetes, thyroid disease, gout, metabolism disease; (7) cataract, glaucoma, retinal and optical; (8) anaemia, haemophilia, spleen disease; (9) vertebra or spinal cord disease, rheumatic disease, muscle, skeleton, joint disease; (10) cancer, tumour, cyst; (11) AIDS; (12) stone (calculus), poisoning.

[197] See *Holmes v. Scottish Legal Life Assurance Society* (1932) 48 TLR 306.

[198] In the trader's combined shops proposal form a question is asked: " Is the building constructed of brick, stone or concrete and roofed with slates, tiles, asbestos, metal, concrete or asphalt?

matter can raise different material facts to be disclosed. For instance, for a fire policy information concerning whether or not the extinguishing equipment is properly installed is material,[199] and the fact of whether or not locks and a burglar alarm have been properly fixed is material to a burglary policy. Generally, the following categories of information are regarded as material for all types of property insurance:

(a) The location of the insured property

Whether or not a property is located in a hazardous area is material information.[200] A Chinese case gives a good example of this.[201] A wooden product company formed a property insurance contract with an insurer under a flood policy. The company's timber was flooded and carried away by water. The insurer declined the claim on the grounds that the timber was located under the warning line of the flood which was not within the scope of the insurance but the proposer failed to disclose this fact. It is held that the insurer was not liable.

(b) The condition of the insured property

The condition of the property is material for any insured property, as it can affect the insurer's decision in assessing the risk or fixing the premium. In a Chinese case,[202] a packing material factory took out an insurance contract of enterprise property insurance of its machines for cardboard production. Two months later, a typhoon hit the area, trees were blown down which destroyed the roof of the building and one of the machines was seriously damaged by a falling fragment of the roof, which caused the

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[199] For example, in the property all risk insurance proposal form, details of the safety facilities are asked for, (1) Is there an automatic alarm? (2) Are there fire hoses and extinguishers, and (3) Is there a security guard?

[200] For example, in the trader's combined shops proposal form of the China Insurance Co.(U.K.) Ltd, a question is asked: "are the premises in an area affected by flooding? In the comprehensive property insurance proposal form of the Ping An Insurance Company of China, the insurer inquires the names, distances of the nearest rivers, lakes and seas and their records of the lowest, normal and highest levels. Generally speaking, the question about the location of the insured property is much more important in China than in England. In China, every year there are floods here and there, especially in the valleys of the Yellow River and the Yongtze River. The recent flooding in China in 1998 was the worst in the last 50 years. Approximately, a quarter of the whole population in China suffered to varying extents, from the flooding. It was reported that the flooding covered 8 provinces, they are Hubei, Hunan, Jiangxi, Anhui, Jiangsu, Heilongjiang, Jilin and Inner Mongolia. The estimated economic loss amounting to 166.6 billion Chinese Yuan, accounting for 2.2% of total GNP of 1997. The estimated claims for insurance money from the China Insurance Property Insurance Company Limited only was up to 3 billion Chinese Yuan. (See Chinese News from Internet, 28th August 1998).

[201] Insurance Studies, No.4, p.57, Beijing, China, 1996.

[202] Zhu Tao and Wang baoshu, Qiye Jingji Jiufen Dianxing Anli Tonglan (Leading cases selections for the enterprises economic disputes), p.721, Enterprise Administration Press, Beijing, 1995.

interruption of the production. The insured made a claim against the insurer. The insurer sent some persons to see the scene of the event, and they discovered that there was a repair mark on that machine which obviously proved that the machine had been damaged and repaired before the occurrence of the event. The proposer did not disclose this material fact to the insurer when the contract was concluded. So the insurer refused the claim due to the insured's non-disclosure of the machine's bad condition. The insured applied for arbitration against the insurer with the Arbitration Committee of the Economic Contracts.[203] The arbitrator held that the machine's defective condition was material and the proposer should have disclosed this to the insurer, the failure of the disclosure of this fact enabled the insurer to decline the claim and rescind the contract.

(c) The use of the insured property

The use of the property and by whom the property will be used is another material fact that the proposer needs to disclose to the insurer. This question is asked by the insurer in nearly all the proposal forms of the property insurance. A car, for instance, has different hazards when being used for the commercial purpose or for private driving, so the question of what purpose the vehicle will be used for is always asked in all vehicle insurance proposal forms. Similarly, a building has different risks when being used for a trading or professional or business purpose, or as a private dwelling house.[204]

(d) The age of the property.

The age of a building or a machine is also regarded as material information. An old building obviously has a higher hazard in respect to earthquake, typhoon and flood, etc. than a new one; an old machine is more likely to break down than a new one.

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[203] There are four ways of insurance dispute settlement in China, namely, negotiation, mediation and conciliation, arbitration and court. A majority of insurance disputes are settled by way of negotiation and mediation and conciliation. Where the two parties fail to reach an agreement after negotiation and mediation, the dispute may be submitted to arbitration or to court for legal action. Such arbitration is carried out by the Arbitration Committee of the Economic Contracts in the place where the defendant is domiciled. According to art. 12 of the Arbitration Law 1995 (PRC), the committee is composed of 10-16 persons, including 1 director, 2-4 deputy directors, and 7-11 members. They should have substantial knowledge and experience in law, trade and economy. After they have made a decision about the dispute, the two parties have to comply with it. If either party fails to do so, the other party is entitled to ask for the court's enforcement. If one or both parties are not in agreement with the decision made by the committee, they still have no other alternative but to comply with it, neither of them is legally allowed to submit the same dispute to court any more.

[204] For example, in the Home Insurance Proposal Form of China Insurance Co., (UK) Ltd., the proposer is required to answer if the building has been used for trade, professional or business purpose.

(3) Motor Insurance:

In England, in motor insurance, apart from the common factors relating to the physical hazards of property insurance mentioned above, the information relating to the driver is particularly important. Lots of matters in respect of the driver are required to be disclosed by the proposer, such as the driver's occupation, age and driving experience, driving record, previous losses and claims.[205] In China, however, there is no inquiry about the driver.[206] It is said this is because in China at the moment a vehicle is not usually driven by a specified driver.[207]

10.2 Moral Hazards

Information relating to the insurance history of the proposer or insured and information relating to criminal convictions of the proposer or insured are usually described as moral hazards in England. The insurance history is regarded as a material fact in China which the proposer is asked to disclose on the proposal form. However, the information in relation to the criminal convictions of the proposer or the insured has never been mentioned by Chinese insurance laws or required by insurers in proposal forms.

Insurance history includes claims which have been made by the insured, refusals by an insurer to issue or renew a policy, cancellation of policies or imposition of a higher rate of premium. It is almost invariably true that a proposer is required to give details of any previous insurance claims which he has made, or refusals of claim or avoidance of policy by any insurer. There are two aspects to insurance history, *i.e.* the insurance history of the insured in relation to the type of insurance he is seeking, and the insurance history of the insured in respect of the type of insurance he is not seeking. In the former situation, the insurance history of the insured is definitely a material

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[205] See proposal form for private car insurance of the Corinthian Insurance Company (UK).

[206] See Motor Vehicle Insurance Proposal Form of Pingan Insurance Company of China and other companies motor vehicle insurance proposal forms.

[207] This was discussed, in 1998, with Zhao Bo, the deputy manager of the Property Insurance Department of the China Property Insurance Company, and Geng renwei, the deputy manager of the International Insurance Business Department of the China Property Insurance Company, Qingdao Branch.

fact.[208] The latter situation is not so clear in China, and the question in relation to the latter situation has not been found in any proposal form. However, in England it seems that the insurance history of the insured in relation to the type of insurance he is not seeking is also material information in common law. In the fire insurance case of *Ewer v. National Employers' Mutual General Assurance Association Ltd*,[209] it was held that the insured was under a duty to disclose his entire claims history in all kinds of insurance. A similar decision was reached in the case of *Locker and Woolf v. Western Australian Insurance*,[210] it was held that the insured's non-disclosure of the fact that his previous proposal for a motor insurance had been rejected in an application for a fire policy entitled the insurer to avoid the policy. It is submitted that the English common law approach is too harsh and not fair to an insured who fails to disclose a fact that is not in relation to the insurance he is looking for.

Another material fact which may affect the moral hazards of the insured is his criminal history. In England, the materiality or otherwise of the insured's criminal history has been subjected to countless judicial pronouncements, but some of these cases seem too harsh for the insured. For example, in the case of *Woolcott v. Sun Alliance and London Insurance Ltd.*[211], the plaintiff effected a fire policy for his house with the defendant. He failed to disclose the fact that he had been convicted of robbery some 12 years previously. It was held this was a material fact, and so the insurer could avoid the policy on the ground of non-disclosure. In another harsh case, *Lambert v. Co-operative Insurance Society Ltd.*,[212] it was decided that the convictions of the insured's husband were material facts. In this case, the plaintiff effected a policy of all risks with the defendant to cover her own and her husband's jewellery in 1963. She failed to disclose the fact that some years earlier her husband was convicted of receiving 1730 cigarettes knowing them to have been stolen and had been fined £25, nor, on the last renewal of the policy in March 1972, did she disclose his conviction in December 1971

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[208] In both England and China this point is applied. For example, in the life insurance proposal of the Pingan Insurance Company of China, it is asked "Has any life insurer cancelled, refused to accept, refused to continue or agreed to continue only on special terms any insurance for the proposer, insured?" But in property insurance, no such kind of question is asked. In England, an insured's insurance history for the type of insurance he is seeking is regarded as material by common law. See the English case of *Arterial Caravans Ltd. v. Yorkshire Insurance Co.*, [1973] 1 Lloyd's Rep. 169.

[209] [1937] 2 All E.R. 193.

[210] [1936] 1 K.B. 408.

[211] [1978] 1 All E.R. 1253.

[212] [1975] 2 Lloyd's Rep 485.

for two offences of dishonesty. Subsequently her jewellery was stolen and she made a claim on her policy. The insurer repudiated her claim on the grounds of not-disclosure of her husband's convictions, and the judgement was made for the insurer.

However, in England, the materiality of the criminal history of the insured may be affected by legislation of the Rehabilitation of Offenders Act 1974 (UK) (ROA). The idea of this Act is that less serious offences should not continue to be held against an offender after a reasonable lapse of time. Instead they become spent convictions.[213] A proposer for insurance is never bound to disclose a conviction which has become spent under the terms of the Rehabilitation of Offenders Act 1974.[214] There is no doubt and no argument that where the policy effected after the effect of the ROA 1974, the Act relieves the proposer from the duty of disclosure of spent convictions. If the policy was effected before the enactment of the ROA, while the dispute on the claim and the subsequent litigation relating to the non-disclosure of spent convictions occurred after the enactment of this Act, the courts may face difficulty in coming to a decision. However, Section 7(3) of the ROA gives the court discretion to admit evidence as to spent convictions if the court is satisfied that "justice cannot be done in the case except by admitting it." The case of *Reynolds v Phoenix Assurance*[215] is the only reported example so far for this situation. The plaintiff had applied for insurance in 1972 – before ROA 1974 came into force – and had failed to disclose the relevant convictions. However, the ROA 1974 had come into force by the time the matter came to trial. Ultimately it was held that the convictions were not material, but the trial judge exercised his discretion by allowing evidence of them to be adduced.

In China, there is so far no requirement for the disclosure of insured's criminal record either by insurance law or on proposal forms. Using English law for reference, it is thought that an insured's criminal record may be regarded as a material fact in China

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[213] S.4(3)(a), there are different periods laid down for rehabilitation depending on the seriousness of the sentence imposed. According to s.5(2), the periods are:
(1) absolute discharge - six months;
(2) conditional discharge/probation - one year;
(3) custodial sentence less than six months - seven years;
(4) custodial sentence over six and less than thirty months - ten years;
(5) any other penalty - five years;
(6) a conviction resulting in a sentence of two and half years imprisonment or more can never become spent..

[214] See J. Birds, Modern Insurance Law, (4th ed.), pp. 115-116. 1997.

which should be disclosed by the proposer. Some criminal offences may have no direct connection with the insurance he is applying for. An insurer can, however, judge the insured's moral character from his criminal record. It is obvious that an insurer would bear a higher risk in providing insurance to a person who had a bad list of criminal offences than a person who had not. So it is suggested that the duty of disclosure of criminal record should be imposed on the proposer by insurance law or on proposal forms. The proposer or insured may be asked by the insurer in the proposal form to disclose his recent serious criminal convictions, such as, convictions during the last five or ten years. However, it is submitted that the requirement of disclosure of the insured's criminal record would be very unlikely to be put into law or on proposal forms, at least for the time being or in the near future. This is because in China, due to sharp competition in the insurance market, some insurers do not ask many questions in relation to the subject matter of insurance on a proposal form, let alone ask questions in respect of criminal convictions. This is so because the insurers want to hold on as many consumers as possible. This question will be discussed later under the caption "the gaps between law and practice in China".

In China, the amount and the source of the proposer's income may be regarded as a material fact as well. In most prevailing proposal forms, especially life insurance proposal forms,[216] this information is required to be disclosed. Indeed, particularly for a long-term policy, the information of the proposer's income may cause an insurer to consider whether the proposer has the ability to pay a premium for a long time. This information might influence the insurer's decision on whether or not he will take the risk.

11. The Insurer's Duty of Disclosure

It has long been assumed that the duty of utmost good faith is reciprocal. When the principle of utmost good faith was established in the classical case *Carter v. Boehm*, the existence of this so-called reciprocal duty of disclosure on the party of insurer was recognised by Lord Mansfield; "The policy would be equally void against the

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[215] [1978] 2 Lloyd's Rep 440.

underwriter, if he concealed, as, if he insured a ship on a voyage, which he privately knew to be arrived, and an action would lie to recover the premium."[217] It indicated that equivalent duties of the disclosure are owed by the insurer to the assured. Moreover, the mutual duty was embodied in the MIA 1906, s.17, it required both the parties of insurer and insured to observe the principle of utmost good faith, if it is not observed by either party, the contract may be avoided by the other party. The law imposes a duty of disclosure on the insurer as much as on the insured. In common law, the first English decision to hold that the insurer owes a duty of utmost good faith to the insured was the case of *Banque Keyser Ullman SA v. Skandia (UK) Insurance Co., Ltd.*[218] this decision was approved on appeal by the Court of Appeal and the House of Lords in *La Banque Financiere de La Cite SA v. Westgate Insurance Co. Ltd.*[219] Further, in *Banque Financiere* a bold attempt was made by the judge, that is, not only should the duty of disclosure apply to the insurer, but the insurer who breaches such duty should be liable for damage to the victimised insured. However, this bold attempt was not accepted by the Court of Appeal and the House of Lords in an appeal where it was held that the only remedy for breach by the insurer was the traditional one of avoidance of the contract. In *Banque Financiere,* a number of banks agreed to make some substantial loans to four companies. The loan was to be secured by a deposit of gemstones supplied by the companies; and to be supplemented by a credit insurance policy. The manager of the insurance brokers who was responsible for arranging the credit insurance fraudulently issued cover notes upon which the banks advanced the first loan for the agreed sums to the companies. The manager of the insurance brokers acted fraudulently; in fact the insurance for the first loan had not been arranged when the cover note was issued. The senior underwriter became aware of such misconduct of the manager but failed to disclose it to the banks. The banks made further loans to the companies. In due course the borrowing companies defaulted on all the loans. It was discovered that the companies had perpetrated a massive fraud on the banks in that the value of the gemstones proved to be worthless. The banks made claims under the polices of insurance against the insurers. The insurer denied liability on the ground that the loss was excluded by the clause reading: "the insurers shall not be liable

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[216] See Life Insurance Proposal Form of Pingan Insurance Company of China Ltd.
[217] *Carter v. Boehm* (1766) 3 Burr, 1905, 97 ER. 162.
[218] [1987] 2 All E.R. 923.
[219] [1989] 2 All E.R. 952; [1990] 2 All E.R. 947.

hereunder for .... any claim or claims arising directly or indirectly out of or caused directly or indirectly by fraud attempted fraud misdescription or deception by any person firm organisation or company." The banks argued that the insurer owed them a duty of disclosure of the manager's fraud, and they sought damages against the insurers. The claims were upheld at the first instance by the judge in a lower court,[220] but the Court of Appeal reversed this decision.[221] The Court of Appeal accepted the view adopted by the judge that the duty of utmost good faith is reciprocal, but it went on to hold that it did not give rise to a remedy in damages. The House of Lords affirmed the judgement of the Court of Appeal.[222] The point that an insurer's duty of disclosure does not extend to giving the insured the benefit of the insurer's market experience and knowledge was further confirmed by the more recent cases of *Norwich Union Life Insurance Society v. Qureshi and Qureshi*[223] and *Aldrich, Day, Civardi v. Norwich Union Life Insurance Co.*[224]

In China, the Insurance Law also imposes a duty of utmost good faith on insurers and this duty may be performed in two ways. Firstly the Law requires insurers to explain to proposers, when making a contract of insurance, the terms and conditions, in particular those concerning exception of the insurer's liability.[225] Secondly, the Law requires the insurer not to conceal material information which is related to the insurance contract.[226]

The requirement for the insurer to explain the terms and conditions is based on two facts. On the one hand, due to the fact that the insurance terms and conditions are complicated and the types of cover are diversified and abundant and are made and understood by the insurer, while the proposer has poor knowledge of them, the insurer is then required to explain them to the proposer. On the other hand, in practice, a great deal of the arguments during the process of claim are caused by the misunderstanding or the lack of knowledge of the terms and conditions of the contract and especially the exceptions of the policy. The Insurance Law therefore intended to solve this problem

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[220] [1987] 2 All E.R. 923.
[221] [1989] 2 All E.R. 952.
[222] [1990] 2 All E.R. 947.
[223] [1999] Lloyd's Rep. I.R. 263.
[224] [1999] Lloyd's Rep. I.R. 277.
[225] Arts. 16 and 17 of the Insurance Law.

by requiring the insurer to explain to the proposer the terms and conditions and especially the exceptions of the contract when the contract is concluded in order that the proposer or insured can understand the terms and conditions and reduce the argument on the insured claim. The Insurance Law especially stresses the insurer's duty of the explanation of the exception terms[227] when making a contract, a breach of such duty renders such terms ineffective. Consequently, the insurer is not discharged where a loss or damage is caused by the events which are expressly excluded in the insurance policy.[228]

The provisions of articles 16 and 17 are a great improvement to protect consumers and aim to avoid or reduce the arguments arising from the misunderstanding of the terms and conditions of the policy or the lack of the knowledge of insurance clauses, especially the exception clause. As Mr Hu comments the stipulation of requiring the insurer to explain the insurance clauses to the proposer is suitable for Chinese situation, because in China a lot of consumers are not well educated, it is difficult for them to understand the complex insurance clauses.[229] However, the problem is that, in practice, it is impossible to explain all the terms and conditions of the policy to every proposer, and some times the insured denies the fact that the insurer has made the explanation to him. Thus, arguments have often been caused in this aspect. For instance, in the case of *A Trade Company v. Insurance Company*,[230] the car of the trade company was insured by the insurance company under the motor vehicle insurance in January 1996. It was burnt by a sudden fire when it was running on the road. The trade company claimed against the insurance company, but was refused by the insurance company on the ground that the fire was spontaneous which was excepted from the coverage of the insurance. The insured took a legal action against the insurer claiming that the insurer did not explain the exception clause to him when the contract was concluded. The court made judgement to the insured because the insurer could not show the evidence that he made the explanation to the insured. In order to avoid and

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[226] Art. 132 of the Insurance Law.

[227] The exclusion of insurer's liability includes: (1) exception of perils, *i.e.* the risks, events or losses which the insurer shall not be liable for and which are stipulated in the policy; (2) franchise, i.e. the insured shall bear himself some certain sums or proportion of the losses he suffered.

[228] Art. 17 of the Insurance Law.

[229] See Hu Wenfu, Shangye Baoxianfa Tonglun (An Introduction to Commercial Insurance Law), p. 157, 1996.

[230] It was cited in Insurance Studies, No. 4, p.41, Beijing, China, 1999.

reduce similar problems, some measures have been taken by insurers. For example, the terms and conditions of the contract are printed on the other side of the proposal form so that the proposer can read them before he fills in the form. In some proposal forms, "Attention" is written on the first page of the form, it reads: "Before taking out the insurance, please read the terms and conditions, especially the exceptions to the contract which are printed on the other side of the proposal form,[231] and ensure all terms and conditions are completely understood and agreed to be performed, then fill out the form." At the bottom of the form, a declaration reads: "I have read and understood the Company's clauses and extensions (including the exceptions)." If the proposer signs the form, it means that he has understood and agreed all the company's clauses. Some writers also suggested that "the exception clauses should be printed in different colours in order to attract the attention of the proposer."[232] It is quite logical to assume that, if the proposer has not asked any question about the terms and conditions, it is deemed that he has completely understood them and is prepared to perform the duties of the contract. Such a warning and declaration should be regarded as an explanation of the clauses of the contract.

The second way that the Insurance Law imposes on the insurer the duty of the utmost good faith is that the Law requires the insurer not to conceal material information concerning the insurance contract.[233] If the insurer or his employees withhold, in the course of insurance operations, important details relating to an insurance contract, deceive the proposer, the insured or the beneficiary, or refuse to perform the obligation of paying insurance moneys as stipulated in the insurance contract, besides enabling the insured to avoid the contract,[234] the insurer will be pursued for criminal liability if a criminal offence is constituted, or a financial penalty will be imposed according to relevant laws where no criminal offence is constituted.[235]

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[231] Now, the insurance clauses of the policies are printed on the other side of proposal forms. However, before the promulgation of the Insurance Law, they were separately printed and the proposer could not read the terms and conditions before the issue of the policy.

[232] Li Jiaming, *Baoxian Zeren Mianchu Tiaokuan Xiangguan Wenti Fenxi (The Analysis on the Relevant Problems of the Exception Clause of Insurance),* Insurance Studies, No. 4, p. 41, 1999.

[233] Art. 105 of the Insurance Law.

[234] The law does not expressly stipulate that the insured is entitled to avoid the contract where the insurer fails to disclose material fact, but the proposer is vested with this right by the principle of utmost good faith itself.

[235] In art. 132 of the Insurance Law, it is stipulated that where an insurance company or its working personnel withhold, in the course of an insurance operation, important details relating to an insurance contract, deceive the proposer, the insured or the beneficiary or refuse to perform the obligation of

As was considered above, in both England and China, the insurance laws imposed the duty of utmost good faith on insurers. However, in both countries some problems have been left to be resolved in respect to the duty of utmost good faith of insurers:

(1) What is the test of materiality for the insurer's duty, that is what facts must be disclosed by the insurer?
(2) What remedies are available to the insured where the insurer breaches his duty of utmost good faith?
(3) Does an insurer have a continuing duty of utmost good faith?

(1) The test of materiality for the insurer's duty:
No insurance laws deal with this question so far. It is submitted that as far as insurers' duty is concerned the materiality of utmost good faith should be based on inference from the formulation of the insured's duty. In England, corresponding to the test of insureds' duty, the appropriate test of materiality of insurers' duty of disclosure would have been that every fact is material which would influence a reasonable insured to decide whether or not he will place the risk in question to be covered by the insurer and the actual insured needs to demonstrate that he had been induced to enter into the contract. Applying this inference, it would have been concluded that, in England, the

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paying insurance moneys as stipulated in the insurance contract, criminal liability shall be pursued according to law if a criminal offence is constituted. Where no criminal offence is constituted, the FSCD shall impose a fine of between RMB 10,000 and RMB 50,000 on the insurance company. Sanctions and a fine of no more than RMB 10,000 shall be imposed on the working personnel who committed the illegal acts." There is no treatment of what is criminal offence in insurance and what liability shall be pursued. In a recent article "*a talk about insurance crime*" by Li Jiaming (Insurance Study, No.7, p.42, 1998), criminal offences in insurance are discussed. He suggests that the term "criminal offence" in art. 132 denotes deceit and fraud. The corresponding criminal punishment by the Criminal Law 1979 (PRC) and amended in 1997 should be control, criminal detention or fixed-term imprisonment. Control is a criminal penalty for minor offence (Chinese Criminal Law uses the word of "control", but it is equivalent to the word of "probation" in meaning). The offender continues to work in his place of employment and continues to receive his normal wages, while undergoing the supervision of the public security organs and the masses. He is required to make periodic reports on his circumstances to the public security organ concerned. The term of control is not less than three months and not more than two years. Criminal detention is a criminal penalty imposed for relatively minor offences. The criminal on whom this penalty is imposed is deprived of his freedom and confined in a detention house by the local organ of public security rather than being put into prison or sent to a place of reform through labouring work as are those serving fixed terms or life sentences. He may go home for one or two days each month and be paid for work. The term of criminal detention is not less than 15 days and not more than 6 months. The term of fixed-term imprisonment is not less than 6 months and not more than 15 years. However, to what extent art. 132 would be put in force is unclear. As far as it is known there has so far been no evidence of prosecutions for these offences being committed or prosecuted.

test of materiality of the insurer's duty should be "reasonable insured mere influence test". This inferred test of materiality seems to require the underwriter to disclose, for example, the fact that the other insurers offered a similar cover but at a lower premium. Such a point seems ridiculous. In *Banque Financiere de La Cite SA v. Westgate Insurance Co. Ltd*,[236] the Court of Appeal held that the insurer's duty of utmost good faith does not extend to giving the insured the benefit of the insurer's market experience, for instance, that the same risk could be covered for a lower premium by another insurer, or presumably, by the same insurer under a different type of insurance contract. The Court of Appeal refused to be drawn further than a general statement of principle:[237] "In our judgement, the duty falling upon the insurer must at least extend to disclose all facts known to him which are material either to the nature of the risk sought to be covered or the recoverability of a claim under the policy which a prudent insured would take into account in deciding whether or not to place the risk for which he seeks cover with that insurer." [238] This approach was adopted in a recent case of *Searle v. A R Hales & Co Ltd.*[239] The plaintiff was induced by brokers (who were her agents) to enter into a home income plan issued by SMA, under which the plaintiff took out a loan secured by a mortgage on her home and used the sum loaned to invest in various bonds which were intended to produce sufficient income both to pay the mortgage and to provide an income for the plaintiff. The bonds dropped in value, with the result the plaintiff was unable to maintain her mortgage payments. The plaintiff claimed that SMA owed her a duty of care to warn her of the nature of the contract and of the risks run by her in relation to it. The judge held that an insurer does not owe any duty of care or duty to speak in the absence of any clear assumption of such a responsibility, and accordingly that SMA bore no responsibility for what had transpired.

In China, corresponding to the insured's duty test, the appropriate test of materiality of

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[236] [1989] 2 All E.R. 952.
[237] *Banque Finaciere* [1990] 1 Q.B. 665, at p. 772.
[238] Lord Jauncey had a different view for the Court of Appeal's approach. He held in *La Banque Financiere* that the insurer's duty of disclosure extended to the safe arrival in port of a vessel which the assured wished to insure, or to the destruction by fire of a house which the insured wished to insure. In short, just as the assured's duty is to disclose facts which would increase the risk of loss, the insurer's duty is to disclose facts which would decrease the risk of loss. His lordship refused to agree the view that the insurer owes a duty to tell the proposer the coverage of the policy he is looking for. I think the insurer should tell the proposer the coverage of the policy he is looking for.
[239] [1996] L.R.L.R. 68.

insurer's duty of disclosure should be defined that every information is material which shall sufficiently influence a reasonable insured's decision on whether or not he will effect a particular policy with the insurer.[240] The exceptions from coverage of an insurance policy are regarded as material information, which shall affect a reasonable insured's consideration of whether he will make the contract with the insurer. So the Insurance Law requires the insurer to disclose this information to the proposer when making an insurance contract.[241] In addition, by mirroring the proposer's duty of disclosure that the proposer is under a duty to disclose facts which would increase the risk of loss, the insurer's duty should be to disclose facts which would decrease the risk of loss or to disclose that the risk which the proposer is seeking to be covered can never occur.

(2) Remedies to the insureds:

In England, until the case of *Banque Financiere,* the rule of the insurer's duty of disclosure did not seem to have any real significance. As was noted above, in this fascinating piece of litigation, there was a bold attempt by the judge, in the first instance, to apply such a duty on an insurer, so as to give it some real teeth by awarding damages for breach of the duty. Unfortunately, this attempt was rejected by the Court of Appeal and House of Lords.[242] In China, according to article 17 of the Insurance Law, it indicates that the damages are available for the insured where the insurer fails to explain the exceptions of the policy when the contract is concluded. The failure to explain to the proposer also renders such exceptions ineffective, and the insurer is still liable even if the loss is excluded by the exception terms of the policy. This sanction may be regarded as a remedy of awarding damages to the insured for a breach of utmost good faith by an insurer. However the insurer's duty of utmost good faith includes not only an explanation of the exception terms but also the disclosure of other important information in respect of the contract,[243] for the latter the Insurance Law

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[240] Because in China, the test of materiality of insured's duty has been determined as the prudent insurer decisive influence test, that is, a fact is material if it shall sufficiently influence the prudent insurer's ...rge the premium. See art. 16 of the Insurance ...f Chinese test of materiality.

...Appeal and House of Lord was that the ...s the traditional one of rescission of

...surance company and its employees not to ...ntract.

does not stipulate whether or not an insured will be awarded his damages. Instead, the Law imposes criminal liability on the insurer if a criminal offence is constituted, or where no criminal offence is constituted, the Law empowers the FSCD to impose a fine of between RMB 10,000 and RMB 50,000 on the insurer.[244]

The question of what remedies are available to the insured in respect to the insurer's breach of his duty of utmost good faith has been strongly argued in England by the authorities.[245] In China, however, there is no argument at all on this question because people have not even thought of it. It is suggested that given that an insurer owes a duty of utmost good faith, the insured shall have the right to be awarded damages where the insurer breaches such a duty. The reasons are given as follows:

(i) A breach of the duty of utmost good faith by an insurer may cause at least three consequences:

(a) If the insured has not suffered any loss when he discovers the insurer's breach of duty, rescission of the policy and recovery of the premium are adequate remedies for him;

(b) If the insured has suffered a loss when he discovers the insurer's breach of duty, but the loss falls into the scope of the insurer's liability, the insured will not be so silly as to avoid the contract, rather he will choose to recover from the insurer;

(c) If the insured does not discover the insurer's breach of duty until he suffers a loss, and this loss falls just outside the liability of the insurer under the policy, what is the proper remedy under this circumstance? This is the only situation in which the insurer's duty of utmost good faith is likely to be of any significance to the insured. However, the prevailing laws in both China and England have not awarded damages for the insurer's breach of duty,[246] and this really renders the insurer's duty almost meaningless. It is suggested that awarding damages to the insured is the proper remedy for the insurer's breach of duty, otherwise it is not fair to the innocent insureds.

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[244] Art. 132 of the Insurance Law.

[245] See case *Banque Financiere De La Cite S.A. v. Westgate Insurance Co. Ltd.* [1991] 2 A.C. 249, affirming the Court of Appeal [1990] 1 Q.B. 665, reversing the judgment at first instance, sub nom. *Banque Keyser Ullman SA v. Skandis (UK) Insurance Co. Ltd.* [1987] 2 All E.R. 923.

[246] Although art. 132 of the Insurance Law 1995 does not stipulates the remedies for a breach of insurer's duty of disclosure, from art. 17 it could be inferred that the insured would be awarded damages where

(ii) As was discussed earlier, where the proposer breaches the duty of utmost good faith the remedy is to entitle the insurer to avoid the contract. In my opinion, the remedy for the breach of duty by the insurer is not necessarily consistent with the remedy for the breach by the proposer. Because the insurer's only financial loss will be the business expenses where he has avoided a policy for the breach of the duty by the proposer.[247] In contrast, where the proposer avoids a policy for the insurer's breach of duty, he will suffer a big financial loss if the loss has already occurred which unfortunately falls into the exception of the policy as was mentioned in (i)(c) above.[248] It is suggested that such a loss should be indemnified by the insurer who breached the duty, or paid proportionately by the insurer according to actual situations[249] in order to reduce the insured's financial losses.

(3) Continuing duty of utmost good faith by insurer:

This question again needs to be discussed separately between English insurance law and Chinese Insurance Law.

In England, it seems that it does not have an immediate significance to argue whether or not an insurer owes a continuing duty of utmost good faith. The reasons are: First, it has yet to be ascertained whether or not an insured owes a continuing duty except in some special situations. It is logically submitted that the insurer does not have a continuing duty of utmost good faith. Second, assuming that the insurer does owe a continuing duty of utmost good faith to the insured, it must be the same conclusion as decided by the Court of Appeal in *La Banque Financiere* that any breach of that duty gives rise to rescission and the restitution of the premium, this consequence renders the insurer's duty pointless.

In China, whether or not a continuing duty of utmost good faith applies to the insurer is

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the insurer fails to perform his duty of disclosure.

[247] Note: in some situations, such as where the insured breach his duty fraudulently, the insurer may retain the premium paid by the insured which may be enough to make up the insurer's business expenses, In this situation, the insurer has, in this sense, suffered no loss at all.

[248] It is the very situation emerged in *Banque Financiere*.

[249] It is suggested that, at least, in practice or by arbitration a compromise payment may be adopted to

a question which has never been attached by law, and never discussed by any authorities. The insured has continuing duty, and likewise, the insurer should be held to have a continuing duty. If this reasoning is correct, the question of what information the insurer should disclose to the insured during the currency of the policy would arise. According to Article 36 of the Insurance Law, the insured has a duty to notify the insurer of any the increase of risk during the currency of the policy, could it be inferred that the insurer has a duty of notification of the decrease of risk insured against during the currency of the policy if he privately knows of it? For example, a ship is insured against war risks during a wartime, later the insurer privately knows that the war has ended before the expiration of the policy, does the insurer have an obligation to notify the insured the information and refund part of the premium to him? By virtue of the implication of article 37 of the Insurance Law, this question seems to be answered "yes". Article 37 provides: "Unless a contract provides otherwise, the insurer shall reduce the premium and refund the corresponding premium calculated on a daily basis under any of the following circumstances:

(1) the degree of risk of the subject matter of insurance has decreased remarkably as a result of the changes to the circumstances under which the premium rate was determined; or
(2) the value of the subject matter of insurance has decreased remarkably.

Whether or not an insurer owes a continuing duty to the insured is a question which needs to be ascertained by the Insurance Law when it is amended.

12. The Gaps between Law and Practice in China

China has a civil law system. The statutory law comes partly from the codification of previous norms, rules and customs and partly from the adoption of other countries' or regions' laws. [250] Judicial precedent has little or no effect on the formation of new laws. The courts follow statutes and complementary rules or regulations in making

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solve this problem where the insurer's breach of the duty is innocent.

[250] For example, the Insurance Law was drafted by referring to the insurance laws of 16 countries and regions, including UK, USA, Japan, Hong Kong, Taiwan, etc. The law adopted a number of rules from these countries and regions which have been proved to be effective in their own country or region.

their judgements on legal cases. Once the law is promulgated, it is followed by people so as to standardize their activities. The questions are (1) to what extent the law is followed in practice in Chinese insurance industry and (2) to what extent the courts follow the strict wordings of the law in dealing with insurance disputes.

(1) There is a big gap between law and practice in China's insurance industry. With regard to the duty of disclosure, the law stipulates that the insurers have the right to ask questions concerning relevant details of the insured subject matter, or of the insured, and the proposer should truthfully answer these questions during the negotiation of the contract. However, in practice, in some proposal forms the insurer does not raise many questions or no question at all relating to material facts, such as the facts in respect to the subject matter of insurance.[251] The reason for this problem is sharp competition among the insurance companies. If a company asks questions or too many questions, the proposers may turn to another insurer who asks no or fewer questions.[252] These sales share the feature of knowing that the less the formality and fuss the more likely people are to buy the insurance. So the insurer deliberately forgoes any real opportunity for enquiry into the risk in the interest of a market share. By contracting this way, surely the insurer takes the risk in every sense. Due to the sharp competition, the insurer has to strike the balance between keeping more consumers but bearing more risks than he should by not requiring the proposer to disclose material information and losing consumers but taking risks corresponding to what would be the right premium by demanding the proposer to disclose material facts. At the moment, when the China's insurance market is at its beginning, the insurers would rather take more risks by asking less questions than lose consumers by asking more questions, even if they do not make any profit for the time being but with a hope to making more profit in the future by keeping more consumers. This is clearly not a normal means for competition.

(2) The second question is to what extent the courts will follow the strict wording of the statutes of insurance. This question, of course, is not a special question in respect

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[251] See the proposal form of home content and building insurance, the People's Insurance (Property) Company of China, Ltd. There is no any question about material information, the information relating to the subject matter of insurance or the insured.

[252] Personal discussion with Mrs Zhang Xiaoling, my former colleague, the deputy general manager of the Ping An Insurance Company of China Ltd, Qingdao Branch, in August 1998.

to the utmost good faith; it involves other aspects of insurance law, and even involves the Chinese legal system. At this juncture, a short account on this point would be helpful in making conclusions and recommendations for this chapter. Generally, courts will uphold the rights of the parties according to a strict interpretation of the terms of the contract and relevant laws. However, sometime they do not make a judgement by strictly following the provisions of the laws. The gap between the law and the way in which it is applied in the courts is reflected in the following matters:

(1) Precedent cases do not have the force of law as they do under common law systems such as those in England and Australia. Therefore, Chinese judges always make their decisions according to their own understanding of the legislative documents before the detailed rules for the law come into being. So it is not uncommon that different judges make different decisions for similar cases;[253]

(2) Most of judges who deal with insurance cases have legal knowledge but do not have enough knowledge of insurance. This would limit them to exercise their judgement and could give rise to more chances of making a wrong decision;

(3) There are also cases where the court will apply the law in a way which is determined by norms which are not found in the text of the law, or the wordings of the law are ambiguous. The fact that such decisions are on occasion inconsistent with the written law is not due to inadvertence by the judge. Rather, it is the results of a conscious departure from the strict terms of the law in order to ensure that certain values are upheld. [254]

How to solve this problem is not my concern in this research. What I am trying to do by discussing the vast gap between law and practice in the current Chinese situations is to draw attention to the government or legislators of the need to take steps to fill this gap.[255]

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[253] See Jiang Diguang, A discussion on a life insurance case, Shanghai Insurance, No.2, pp. 24-25, Shanghai, China, 1997. In this article the writer analysed two similar life insurance cases, but the judicial decisions were different.

[254] Duncan Webb, "*Towards a contract law of China: some salient features*", [1996] LMCLQ, pp.245-267.

[255] In other areas such as insurable interest and subrogation, gaps between law and practice also exist.

13. Conclusion

By the examination of Chinese, English and Australian laws relating to the doctrines of non-disclosure and misrepresentation, the following conclusions can be reached:

(1) Basically, the provisions relating to non-disclosure and misrepresentation in the Insurance Law is, to some degree, in agreement with the Chinese situation. Although the words of utmost good faith can not be found in the Law, the meaning of this principle has been incorporated in articles16, 17, 36, 53, 105 and 132, etc. The 1995 Law, compared with previous laws such as the Regulation on Property Insurance 1983 and the Maritime Code 1992, has reflected the lawmaker's intention to improve the proposer's and insured's legal position in terms of the test of materiality, the inquiring disclosure and the consequences of the failure to perform this duty. Efforts are still necessary for further improvement of the insured position especially for the application of the basis of the contract clause in the proposal form and the remedy for the breach of the utmost good faith by the insurer.

(2) With reference to English and Australian approaches in respect to non-disclosure and misrepresentation, the test of materiality has been determined in the Insurance Law as a prudent insurer decisive influence test. The English prudent insurer mere influence test has long been submitted to be too harsh to the consumer. The Australian's actual insured or reasonable person test seems, at present, not to be a good alternative for Chinese situations, but it may be a promising alternative for English circumstances which is approved by British law reformers and is commended to be followed as a model when reforming English law.

(3) As far as the consequences of non-disclosure and misrepresentation are concerned, the English all-or-nothing remedy is held to be unsatisfactory, especially for the negligent or innocent non-disclosure or misrepresentation. The Australian approach for the remedies for negligent or innocent non-disclosure and misrepresentation is

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but the problem is more serious in the area of non-disclosure, so this is discussed in this chapter.

worthwhile to be taken as reference when amending Chinese law in respect of remedies for non-fraudulent non-disclosure and misrepresentation. Section 28(3) of the ICA 1984 (Australia) provides: "If the insurer is not entitled to avoid the contract or,[256] being entitled to avoid the contract (whether under sub-section(2) or otherwise) has not done so, the liability of the insurer in respect of a claim is reduced to the amount that would place him in a position in which he would have been if the failure had not occurred or the misrepresentation had not been made."

(4) The Chinese approach of inquiring disclosure imposed on the proposer by answering the questions raised by the insurer on the proposal form is suitable to the Chinese situation. However, there is a lack of detailed rules to standardise the proposal forms in terms of the questions. It is suggested that the Statement of General Practice of ABI could be followed in this aspect.

(5) There is a significant gap between law in paper and law in action in China. In the present Chinese situation, some insurers do not raise any questions about material information on some proposal forms in order to gain more consumers. So the insurers bear more risks but receive lower premium than they should. These situations need to be intervened by the China Insurance Regulatory Commission.

(6) Article 222 of the Maritime Code adopts the prudent insurer mere influence test of materiality. A wider voluntary disclosure is not suitable for the Chinese situation. It is suggested this article should be modified to be consistent with the prudent insurer decisive influence test and inquiring disclosure adopted in the Insurance Law for non-marine insurance.

Some recommendations for amendment to the articles relating to non-disclosure and misrepresentation in Insurance Law are made which can be seen in Chapter six.

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[256] For a fraudulent non-disclosure and misrepresentation, the insurer is entitled to avoid the contract. See s.28(2) of the ICA 1984 (Australia).

Chapter Five: Subrogation

1. Introduction

Subrogation, like insurable interest and utmost good faith, is another distinctive principle in insurance contract law. This principle is, however, applicable only to indemnity insurance contracts (principally insurance on property, fire, liability insurance, etc.)[1]. Every country has its own law relating to the application of the doctrine of subrogation. In England, it has been governed by the common law for general insurance and the MIA 1906 (U.K.) section 79 for marine insurance. In China, relevant matters of the principle of subrogation are stipulated in articles 43, 44, 45, 46 and 47 of the Insurance Law for general insurance and a marine insurer's right of subrogation was codified in articles 252, 253 and 254 of the Maritime Code. In Australia, the ICA 1984, sections 65, 66, 67 and 68 deal with the matters of subrogation, and this Act has altered the general principle of subrogation in a number of important respects.

Relevant provisions of the Insurance Law seem to mistake the real meaning of the doctrine of subrogation and to confuse the concepts of subrogation and assignment, so some contradictions arise from these provisions. For example, Article 44 stipulates "Where a third party damages the subject matter of insurance, thereby leading to the occurrence of an event insured against, the insurer shall, from the date of payment of insurance moneys to the insured, be subrogated to the insured's right to claim indemnity from a third party within the amount of indemnity." It continues in the third paragraph of this article that "The insurer's exercise of his right of claim by subrogation in accordance with the first paragraph shall have no impact on the

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[1] Subrogation rights in fact are conferred in a number of other areas of the law, for example in the case of trading trusts, and in contracts of suretyship. However these other categories appear to have had very little influence on the development of the insurance aspects of subrogation, and the court in cases concerned with insurance subrogation invariably have had regard only to the principles enunciated in other insurance cases. Indeed Lord Diplock warned in *Orakpo v. Manson Investments Ltd* [1978] A.C. 95 at 104 that it is "particularly perilous" to "attempt to rely upon analogy to justify applying to one set of circumstances which would otherwise results in unjust enrichment a remedy of subrogation which has been held to be available for that purpose in another and different set of circumstances". For more details see Charles Mitchell, *The Law of Subrogation,* Clarendon Press, Oxford, 1994.

insured's right to claim indemnity from the third party for the portion which has not been indemnified." In this article it uses the word of "subrogation" but the meaning of it is, in fact, assignment. One of the two important limbs of subrogation is that the insurer must use the insured's name to exercise his subrogation right against the third party. However, the Insurance Law does not stipulate whose name will be used when the insurer exercises his subrogation right against a third party. If applying the general principles of subrogation to explain this article, *i.e.* the insurer exercises his right by using the insured's name, article 44 must be self-contradictory. For instance, the third paragraph of this article stipulates that the insurer's exercise of his right of claim against the third party shall have no impact on the insured's right of claim against the third party for the portion which has not been indemnified by the insurer. If the insurer uses the insured's name to sue against the third party for his own benefit and at the same time the insured uses his own name to sue against the same third party for his uninsured parts, the situation would be that the insured would sue twice against the third party on the same case. Such a situation is not allowed in the Chinese legal system. So article 44 must mean that the insurer uses his own name to take action against the third party; if so, it is assignment rather than subrogation. Another limb of subrogation is that the insurer has the right to recover from the insured any compensation that the insured himself may obtain in diminution of his loss.[2] However, the Insurance Law does not provide anything about the second limb of subrogation. Again the Law does not stipulate how to distribute the recoveries claimed from the third party; the reason for this lacuna will be discussed later.

Another problem is that, in China, most indemnity insurance policies contain express clauses about subrogation, some of which, however, are inconsistent with the general principles of subrogation or conflict with the provisions of the legal subrogation.[3] Unfortunately, the Insurance Law does not give any solution to this problem. There are also other problems in the Insurance Law and practice which need proper solutions.

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[2] See the English leading authority of *Castellain v Preston* (1883) 11 Q.B.D. 380. In this case the Court of Appeal made it clear that the principle of subrogation encompasses not only the right of an insurer to stand in the shoes of its insured and to enforce any claims possessed by the insured against third parties which will have the effect of diminishing the loss insured against, but also its right to recover from the insured any benefits actually received by him from a third party in diminution of the loss.

It is therefore proposed in this chapter, firstly, to analyse Chinese statutory provisions in respect of the doctrine of subrogation to find out what problems there are in Chinese law; secondly, to examine English and Australian laws to see whether their solutions could be "borrowed" to solve the problems of Chinese law and, where necessary, approaches from elsewhere will be sought; and finally I will make some suggestions and recommendations for the amendment of the Insurance Law relating to subrogation.

It is not intended to adopt Hasson's approach that criticises the principle of subrogation to such an extent that it seems that the doctrine needs radical change as a whole.[4] Rather, it is intended to analyse rules arising from the principle of subrogation as it applies to the contracts of insurance so as to seek fair solutions to the problems in Chinese insurance law and practice in respect to the principle of subrogation. Specific questions will be raised in relevant subsections. To begin with, it is appropriate to consider the nature and origin of subrogation.

2. The Nature of Subrogation in Insurance Law

2.1 Definition and the meaning of subrogation

Subrogation is literally 'substitution'.[5] It means that one party who has discharged a debt for which a third party is liable is substituted for another so that he may enforce that other's right against the third party for his own benefit. This concept was known in Roman law. By the close of the eighteenth century the English courts of law and equity had come to recognise rights of subrogation in a number of separate legal relationships, one of which was the contract of indemnity. This is how rights of subrogation got attached to insurance contracts.[6]

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[3] See s.10 of this Chapter "Contractual Subrogation" *infra.*

[4] See Hasson R.A. *Subrogation in Insurance Law: A Critical Evaluation*, Oxford Journal of Legal Studies 5 (1985) 416-438.

[5] See *The Compact Edition of the Oxford English Dictionary* (Oxford, 1987), ii. 3126, s.v. 'Subrogate' and 'Subrogation', and ii. 3177, s.v. 'Surrogate' and 'Subrogation'.

[6] See MacGillivray on Insurance Law, (9th ed.), p.531, para. 22-1. London Sweet and Maxwell, 1997.

The justification of the doctrine in insurance is to prevent the unjust enrichment of the insured. This hinges on the indemnity nature of insurance contracts. It is an instance of the fundamental principle of indemnity insurance that an insured cannot recover more than full indemnity for his loss, *i.e.* he cannot make a profit out of such a contract at the expense of either the insurer or a third party. In the classic case of *Castellain v. Preston*[7] Brett L.J. said: "The fundamental rule of insurance law is that the contract of insurance contained in a marine or fire policy is a contract of indemnity, and of indemnity only, and this contract means that the assured, in the case of a loss against which the policy has been made, shall be fully indemnified, but shall never be more than fully indemnified."[8] That dictum based the justification on the principle of subrogation in insurance law, namely the insured cannot make a profit at the expenses of the insurer and the wrongdoer third party.

Subrogation is the corollary of the principle of indemnity, so it must be concluded that this doctrine applies only to indemnity insurance, but not to non-indemnity insurance. This raises a question of what contracts of indemnity actually are. It seems difficult to give a clear-cut answer because there are still different views about this question. But there is no doubt that life insurance does not fall into this category.[9] Generally, indemnity insurance refers to marine, fire, motor, property and liability insurance.[10] At this stage, it is not very important to discuss which insurances are indemnity insurance and which are not, though it may be relevant to later discussion.

Where the contract of insurance is one of indemnity, after the insured has been indemnified for his loss by the insurer, the insurer acquires two distinct rights from the insured – the right to any benefits already in the hands of the insured which extinguishes or diminishes the loss and the right to any cause of action which the insured may have against a third party, in relation to the said loss. The transference of

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[7] (1883) 11 Q.B.D. 380.
[8] *Ibid*, at 387.
[9] Some writers comment that an insurer may exercise subrogation right in medical treatment insurance. See Legal advisor, *Whether an insurer may exercise subrogation right in personal insurance?* Minzhu Yu Falu (Democracy and Law) No. 8, p. 60, 2001. Whether or not an insurer may exercise subrogation right in accident insurance, see Pinhas Ben-Zvi, *Subrogation and Personal Accident Insurance* [2001] I.J.I.L., Part 4, Oct., pp. 336-342.
[10] For more details, See J. Birds, Modern Insurance Law, (4th ed.), p. 284, 1997. See also Birds, *Contractual Subrogation in Insurance,* [1979] J.B.L. p.132.

both these rights from the insured to the insurer is known as subrogation in insurance law. These two aspects of subrogation will be fully considered later.

2.2 The origins of the doctrine of subrogation

There is no dispute that the origin of the doctrine of subrogation can be traced back to Roman law.[11] In *John Edwards & Co Ltd. v. Motor Union Insurance Co. Ltd.*[12] McCardie J. said that the doctrine of subrogation "was derived by our English courts from the system of Roman law. .... The doctrine has been widely applied in our English body of law, *e.g.* to sureties and to matters of *ultra vires* as well as to insurance. In connection with insurance it was recognized ere the beginning of the eighteenth century." However, in England, there was a strong argument about whether this doctrine derived from equity or common law. This question had been argued for a long time until the case of *Lord Napier v. Hunter* [13] in which the argument was settled. The House of Lords held that the right of subrogation derives from equity.

One theory regards subrogation as a general equitable principle which was probably first developed in England in the Courts of Chancery and Admiralty.[14] A number of authorities refer to it as a creature of equity. The earliest statement of the nature of the right of subrogation in the insurance context is to be found in the judgement of Lord Hardwicke in *Randal v. Cockran.*[15] It was held that the plaintiff insurers, after making satisfaction, stood in the place of the assured as to goods, salvage, and restitution in proportion to what they paid. Lord Hardwicke said: "The plaintiffs had the plainest equity that could be." The notion that subrogation is an equitable right has been reaffirmed in subsequent cases.[16] In *Burnand v. Rodocanachi*[17], Lord Blackburn said

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[11] See S.R. Derham, Subrogation in Insurance Law, p.4, The Law Book Company Limited, 1985.
[12] [1922] 2 K.B. 249.
[13] [1993] 2 W.L.R. 42. [1993] A.C. 713; [1993] 1 All E.R. 385.
[14] See Goff and Jones, The Law of Restitution, (5th ed.), pp.121-122, Sweet & Maxwell, 1998.
[15] (1748) 1 Ves. Sen. 98; 27 E.R. 916
[16] The old cases which upheld the view that the doctrine of subrogation was derived from equity are expertly analysed by Derham, Subrogation in Insurance Law, 1985, chapter 1. For example, Bosanquet J. in *Yates v. Whyte* (1838) 4 Bing. (N.C.) 272; E.R. 793 at 798 said that the insured "has the legal right to the damages, and if the underwriters have an equitable right they will establish it in another court". There is also an Australian authority supporting the equitable nature of subrogation, see the statement of Hale J. in the Western Australian Supreme Court in *Hartford Fire Insurance Co. v. Hurse* [1962]

in reference to a marine policy: "If the indemnifier has already paid it, then, if anything which diminishes the loss comes into the hands of the person to whom he has paid it, it becomes an equity that the person who has already paid the full indemnity is entitled to be recouped by having that amount back."[18] In *Morris v. Ford Motor Co., Ltd.*[19] Lord Denning M.R. refused the cleaners' claim against Ford's employee by using Ford's name, on the reasoning that subrogation was an equitable remedy and could be refused where it would be inequitable.[20]

The other more recent theory in England is that subrogation is a common law principle which is implied in every contract of indemnity by the operation of law. The typical authority which represents the contractual theory of subrogation is the judgement delivered by Diplock J. (as he was then) in *Yorkshire Insurance Co. Ltd v. Nisbet Shipping Co. Ltd*[21], though it was found in some earlier cases[22]. His Lordship explained what he considered to be the relationship of subrogation to both law and equity. He said: "The doctrine of subrogation is not restricted to the law of insurance. Although often referred to as an 'equity' it is not an exclusively equitable doctrine. It was applied by the common law courts in insurance cases long before the fusion of law and equity, although the powers of the common law courts might in some cases need to be supplemented by those of a court of equity in order to give full effect to the doctrine; for example, by compelling an assured to allow his name to be used by the insurer for the purpose of enforcing the assured's remedies against third parties in respect of the subject-matter of the loss." [23]

W.A.R. 1987 at 191. See also Lords Goff & Jones, The Law of Restitution, (5th ed.) pp. 121-131, Sweet & Maxwell, 1998.

[17] (1882) 7 App. Cas. 333.

[18] *Ibid*, at 339. Similar opinions were expressed by Wynn-Parry J. in *Re Miller, Gibb & Co. Ltd.* [1957] 1 W.L.R. 703 at 707.

[19] [1973] 1 Q.B. 792.

[20] *Ibid*. at 801.

[21] [1962] 2 Q.B. 330.

[22] This theory was founded as early as 1882 in *Burnand v. Rodocanachi Sons & Co.* (1882) 7 App. Cas. 333, in which Lord Fitzgerald considered that the insurer may recover from the insured any compensation received by him from a third party in diminution of the loss by means of the action for money had and received. It was also found *in Boag v. Standard Marine Insurance Co. Ltd.* [1937] 2 K.B. 113; in this case, Scott L. J. said (at p. 122) that the insurer has a "contractual right" to any compensation coming into the hands of the insured from third parties, at 128; while Lord Wright in that case commented that the right of subrogation "is an integral condition of this policy".

[23] *Yorkshire Insurance Co. v. Nisbet Shipping Co.* [1962] 2.Q.B. 330, at 339.

The above two views were seriously considered by the House of Lords in *Napier v. Hunter*.[24] This case in fact involved a reinsurance policy. The insureds were members of Lloyd's syndicate who reinsured the risks they had agreed to bear by insuring with "stop loss" insurers (they were Lloyd's syndicates as well). Losses occurred and claims on the insurance were made against the stop loss insurers. The insurers indemnified the insureds. Money was consequently recovered from the third party whose negligence had caused the loss to the insureds. These recoveries were held by a firm of solicitors. There were two issues in this case. The first was whether the stop loss insurers had an equitable proprietary interest in any of the settlement moneys recovered from the third party and whether any of the settlement moneys were impressed with a trust in favour of the stop loss insurers. The second was whether, in any event, in determining the amount that the stop loss insurers were entitled to claim in respect of the settlement moneys, the stop loss insurers were entitled to be reimbursed any indemnity paid by them to an assured before that assured was fully indemnified by applying his share of the settlement moneys to a loss occurring below the excess in that assured's policy. On the first issue, the House of Lords held that on payment to the assureds under the policies the doctrine of subrogation had conferred on the stop loss insurers an equitable proprietary right in the form of a lien over the settlement moneys and the stop loss insurers were entitled to injunctions restraining the firm of solicitors from paying and each assured from receiving any part of the settlement moneys until the amount due to the stop loss insurers had been paid to them.[25] It is clear from this case that the House of Lords is in favour of the right of subrogation arising in equity rather than under implied terms in the contract. The second issue involved the destination of the recovered moneys, which will be fully considered later.

It is significant to distinguish these two theories so far as the following are concerned:

(1) How does the court deny the insurer's subrogation right? Must the court refuse a subrogation right by showing that it is inequitable or must it show an implied term to the contrary? As was mentioned above, in *Morris v. Ford Motor Co.*[26] the majority[27]

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[24] [1993] 2 W.L.R. 42; [1993] A.C. 713; 1 All E.R. 385.
[25] [1993] 2 W.L.R. at 43.
[26] [1973] 1 Q.B. 792.

of the Court of Appeal declined to allow Cameron to exercise its subrogation right, but for different reasons. Lord Denning's reasoning relied on the equity notion and James L.J. based on the implied term theory.

(2) Where there is an express subrogation clause in the policy, what is the consequence under the two different theories? A general equitable principle should not be capable of being modified or excluded by an express term, but the rights and duties normally attached to it could be expressly modified by the term. If the right of subrogation is derived from an implied term in the contract of insurance, it may be argued that an express subrogation clause would remove any need for an implied term.[28]

(3) What is the insurer's remedy if the insured recovers more than the loss, but becomes insolvent? By the implied term notion the insurer is only an ordinary creditor and then would be confined to a dividend in the bankruptcy, while, if it is an equitable principle, the insurer has a proprietary right to claim the whole money he has paid to the insured.[29] For example, if the insured has suffered a loss of £2,000 which includes £1,600 insured loss and £400 uninsured loss. The insurer has paid the insured the £1,600 and the insured has subsequently recovered £2,000 from the third party, but the insured became insolvent. The insurer would be confined to a dividend in the bankruptcy if the principle of subrogation is from an implied term, while he would have a proprietary right to claim the £1,600 in the bankruptcy if subrogation is on the basis of equity.

It seems, on the surface, that whichever view is better does not matter to Chinese insurance law merely because there is neither an equity court nor a common law court in China, and it is a civil law system country where the written law prevails, and where the courts make their decision by following the provisions of statutory laws and regulations. However, this view is wrong; in fact there is equity in China. On the one hand, equity in China, in its true and genuine meaning, is the soul and spirit of all law.[30] Indeed, the nature of equity is reflected in Chinese written law[31]. On the other

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[27] Lord Denning M.R. and James L.J., Stamp L.J. dissenting.

[28] See Birds, *Contractual Subrogation in Insurance* [1979] J.B.L. 124 at 128.

[29] See *Napier v. Hunter* [1993] 2 W.L.R. 42. See also Derham, Subrogation in Insurance Law, p.4, Note. 2, 1985, in which he analysized the relevant decisions made before *Napier*.

[30] See Hyung I. Kim, Fundamental Legal Concepts of China and the West – A Comparative Study, p.66, National University Publications, London, 1981.

hand, in China, judges are, sometimes, influenced by equity when they make their decision rather than strictly guided by written law. Although there is no separate court of equity in Chinese legal system, a similar concept of equity is operative with human sentiment and reasonableness as its standards which are relative to times and places and circumstances. They are to be applied with reference to the facts of the case in hand, recognising the uniqueness of individual cases. Such standards of equity supplement the principle of equity within the written law, namely treat all like cases alike, and made the rigid and exact mechanistic application of law more flexible, even going beyond the bounds of fixed written law if necessary, according to circumstances of individual cases. For example, in a Chinese case, where a leather company had mistakenly ordered leather pieces of a significantly smaller size than intended, the court amended, through mediation, the terms about the size of the contract to make them more reasonable. If the court had made the judgement strictly according to the terms of the contract as it was, the leather company would have had to take what they had ordered even if it was the wrong size.[32] In the Civil Procedure Law of the PRC 1991, a power to mediate is conferred upon the People's Court a civil case by provisions in articles 85 to 91.

In a broader sense, equity stands for justice, just law and just decisions. It suggests a humane and reasonable approach to law. Thus equity denotes the ethical and moral principles superior to ordinary legal rules. In short, it lays stress on the essence rather than the form and technicality of law. Therefore, in dispensing justice, equity in this broader sense requires that judgement be rendered sometimes on the basis of reason and ethical principles unfettered by the rigors of positive law. However, an arbitrary adjudication may occur by the fluctuating emotions of the judges. To prevent its occurrence, it is necessary to develop some equity rules which can be invoked by

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[31] For example, in the Civil Law 1986 (PRC), art. 4 stipulates that civil activities must be carried out in accordance with the principles of voluntariness, fairness, exchange of equivalent values, honest and good faith. In art. 10 of the Insurance Law, it is stipulated that an insurance contract between a proposer and an insurer shall be concluded in accordance with the principles of equality, mutual benefit, consensus and voluntariness and may not harm the public interest. The words equality and mutual benefit here are in fact partly reflected the nature of equity. The Chinese words "Gong Ping" in art. 10 was translated into English word "equality" which can not totally express the whole legal meaning of "Gong Ping". In fact, "Gong Ping" denotes not only the idea of equality, but also has the legal meaning of balance, fairness and justice which in essence is equity.

[32] It was cited in Wang , Business Law in China , p. 105, Hong Kong, 1992.

judges when making their decisions. In this sense, English equitable rules in relation to the insurer's right of subrogation may be considered as a reference when improving Chinese insurance law.[33]

3. Statutes Relating to Subrogation in Chinese Insurance Law

In China, the rights and obligations of the parties of an insurance contract are now regulated by the Insurance Law; so is the principle of subrogation. Before the enactment of the Insurance Law, some other statutes and regulations had been applied to govern the insurance parties' activities; the principle of subrogation was also adopted in those statutes and regulations. In the Economic Contract Law 1981, article 25 (3), it is stated: "Where the insured property sustains a loss within the scope of the insurance cover for which a third party is held responsible, and if the insured makes a claim against the insurer, the insurer may make indemnity in advance according to the provisions of the contract of insurance. In such a case, however, the insured shall subrogate to the insurer the right of recovery against the third party and assist him in pursuing such recovery." In the Regulations on Contracts of Property Insurance 1983, a very similar provision was provided.[34] Though the two provisions were worded in a straightforward manner, the meaning of them may be misunderstood because of the use some indefinite or ambiguous words. For example, both of the two provisions use the wording that "the insurer *may* make indemnity in advance according to the provisions of the contract of insurance if the insured claims against him." Consequently, one might be misled into thinking that the insurer *may* or *may not* pay the insured where the loss is caused by a third party, and even some insurers misunderstood this. In a

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[33] With regard to equity in subrogation, English courts have granted an insurer equitable rights, namely, an insurer has a proprietary right in the form of an equitable lien over settlement moneys or judgement sums received in respect of the loss; and an insurer has a equitable right to compel the unco-operative insured to lend his name to the insurer to pursue a claim against the third party. On the other hand, English courts are able to invoke the principle of equity in making a judgement against inequitable subrogation, such as, in the case of *Morris v Ford Motor Co. Ltd.* [1973] QB 792.

[34] In art. 19, it states: "If the insured property sustains a loss within the scope of cover for which a third party shall be held liable, the insured shall file a claim with such a third party. The insurer may make indemnity in advance according to the provisions of the contract of insurance if the insured claims against him. In such a case, however, the insured shall subrogate to the insurer the right of recovery against the third party and assist him in pursuing such recovery."

Chinese case *Shi He Zi Railway Station v. Shi He Zi Insurance Company,*[35] the Railway Station took out motor vehicle insurance for its coach with the Insurance Company in 1992, the insured sum being RMB 132,000. The coach was seriously damaged by a collision with a truck. The driver of the truck was held completely liable. The Railway claimed against the Insurance Company. The Company refused payment and stated that, as the accident was caused by a third party, the insured should file a claim directly against the third party or against the truck's insurance company (the truck was covered by another insurance company). The insured had no alternative but to file claims against the third party and the truck's insurer. The third party could not afford to pay him and the truck's insurer rejected to pay on the ground that the truck was borrowed by the driver who was not insured under the policy. The insured then brought a suit against his own insurance company. The court made judgement for the insured. The insurer appealed and contended that the insured had waived the right of claim against the third party before it transferred the subrogation right to it, so it refused to make indemnity.[36] The High Court dismissed the appeal and restored the original judgement made by the lower court.[37]

Two questions raised in this case need to be discussed here. First, due to the ambiguity of and misleading nature of the provisions of the Economic Contract Law[38] and the Regulations on Contracts of the Property Insurance[39], the insurers misunderstood the law and thought that they could be relieved from liability where an insured loss was caused by a third party and the insured should claim directly against the third party. This thought conflicts with the two fundamental principles which came from English common law and to which the subrogation right becomes the corollary. (1) If a person suffers a loss for which he can recover against a third party, and is also insured against such a loss, his insurer cannot avoid liability on the ground that the insured has the

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[35] See Renmin Fayuan Anli Xuan (The Selected Cases of the People's Court) No. 4, p.130, 1994.

[36] In this case, the insurance company wrongly thought that (1) where the insured loss is cause by a third party, the insurance company "may not" pay the insured; (2) Where the insured failed to file claim against a third party or he did but failed to recovery from the third party, that amount to that the insured waived his right and prejudiced the insurer's subrogation right.

[37] The court made their decision by citing the following statutes and regulations:
(a) Arts. 6 and 9 of the Economic Contract Law; (b) Arts. 16,17,18and 19 of the Regulation of the PRC on Contracts of Property Insurance; (c) Arts. 1 and 23 of the Motor Insurance Policy of the People's Insurance Company of China (PICC).

[38] See art. 25 of the Economic Contract Law.

[39] See art. 19 of the Regulations on Contracts of Property Insurance 1983.

right to claim against the third party.[40] (2) Conversely, the third party, if sued by the assured, cannot avoid liability on the ground that the assured has been or will be fully indemnified for his loss.[41] Secondly, still due to the ambiguity of and misleading nature of those provisions, the insurer misunderstood one of the general principles of subrogation, *i.e.* the insurer cannot be subrogated to the insured's right against a third party until he has paid the insured. Fortunately, these two problems were all solved by the Insurance Law. In article 44 of the Insurance Law, it is stated: "Where a third party damages the subject matter of insurance, thereby leading to the occurrence of any event insured against, the insurer shall, from the date of payment of insurance moneys to the insured, be subrogated to the insured's right to claim indemnity from a third party ....." This article clearly solved the two problems mentioned above that where the insured suffers a loss within the scope of the insurance, for which a third party is liable, (1) the insurer cannot avoid liability on the ground that the insured has the right to claim against the third party; (2) the insurer cannot be subrogated to the insured's right of claim against the third party until he makes indemnity to the insured.

Even worse, before the enactment of the Insurance Law, sometimes the court made wrong judgement due to their misunderstanding of the relevant provisions caused also by the ambiguity of those provisions. In a Chinese case of *Guang Zhou Commercial Corporation v. China Airline*, [42] 15,600 pigeons owned by Guang Zhou Commercial Corporation were insured with the Guang Zhou Insurance Company of China in Oct. 1987 with the insured amount of RMB 60,000, while the total value of the pigeons was RMB 221,325. When they were transported by plane from Guang Zhou city to Bin Hai city, 10,180 pigeons were suffocated to death during the journey due to the malfunctioning of the air-conditioners on the plane. The total loss was RMB 157,687 (the value of the dead pigeons plus other costs). The insurer paid the Corporation RMB 39,150 under the policy (10180/15600 x 60,000 = RMB39,150). The Corporation then sued the airline for the rest of the loss of RMB 118,537 (the uninsured loss + other costs). It was held that according to article 19 of the Regulation

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[40] See MacGillivray on Insurance Law, (9th ed.) pp. 531-532, Para. 22-2, 1997.
[41] *Ibid.*
[42] See Zhu Tao and Wang Baoshu, Qiye Jingji Jiufen Dianxing Anli Tonglan (Leading Cases Selection for the Enterprises Economic Disputes), pp. 726-729, Business and Administration Press, 1995, Beijng.

on Property Insurance Contracts[43], since the insurer had paid the Corporation, his right of claim against the airline was transferred to the insurer and he had then no right to claim for the RMB 118,537 from the airline. In fact the court misunderstood article 19 which means that the insurer shall be transferred the right within the amount of the payment, but the court misunderstood that once the insurer has paid the insured, the insured should transfer the whole right of claim against the third party to the insurer, even if the payment is part of the actual loss and the insured had no right to claim the part which was uninsured by the policy.[44] If the case had occurred after the enactment of the Insurance Law, the judgement would have been different, because article 44 of the Insurance Law expressly stipulates that "..... the insurer shall be subrogated to the insured's right to claim indemnity from a third party within the amount of the indemnity (para. 1). It is also stated: "The insurer's exercise of his right of claim by subrogation in accordance with the first paragraph shall have no impact on the insured's right to claim indemnity from the third party for the portion which has not been indemnified (para. 3)."

In the Insurance Law, five articles, 43, 44, 45, 46 and 47, concern the application of the principle of subrogation. These articles deal with the matters that when the insurer may exercise his subrogation right, how to exercise the right, what the limitations are when an insurer exercises his subrogation right and what the insured's obligations are in respect of the subrogation as well as on which persons the insurer cannot exercise his subrogation rights and so on. However, many problems are derived from these articles which will be discussed in detail later in this chapter.

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[43] See note 34 *supra*.

[44] Due to the ambiguity of art.19, it was really difficult to understand its real meaning. If it was understood as an assignment, the insurer should use his own name to sue the third party and within the payment he has made to the insured for the insured loss and upon the assignment of the claiming right against the third party from the insured to the insurer. The insured was allowed to claim against the third party for the uninsured loss, if any. If art. 19 was understood as subrogation, the insurer had to sue the third party by using the insured's name for the whole loss for his own benefit and the insured's benefit (if the loss included insured loss and uninsured loss), and then the proceeds (from the third party) should be distributed between the insurer and the insured. The difference between the subrogation and the assignment as well as the matter of the distribution of the proceeds will be discussed soon in detail.

Marine insurance is governed by the relevant provisions in Chapter 12 of the Maritime Code,[45] in which articles 252-254 describe the rules for the application of the principle of subrogation.[46] These articles are similar to the relevant articles of the Insurance Law, so they will not be considered separately, though some of them will occasionally be taken as examples.

4. Subrogation and Assignment

Subrogation and assignment are two distinct doctrines. In England there is no problem in distinguishing between these two, but in China, both in Insurance Law and in practice, these two doctrines are confused. Thus it is important and necessary to consider the differences between the two doctrines and to clarify the confusion of these two doctrines in the Chinese Insurance Law and practice before discussing any other problems.

4.1 Differences between subrogation and assignment

Subrogation and assignment are different rights vested in the insurer to sue the third party. Both of them permit one party to enjoy the rights of another, and in many respects a subrogated insurer is in a position similar to that of any equitable assignee of the insured's choice in action, but it is well-established that subrogation is not a species

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[45] Art. 147 of the Insurance Law states: "Marine insurance shall be governed by the relevant provisions of the Maritime Law. Matters not provided for in the Maritime Law shall be governed by the relevant provisions of this law."

[46] Arts. 252 to 254 consider the matters of the principle of the subrogation. In art. 252 it is stated: "Where the loss of or damage to the subject matter insured within the insurance coverage is caused by a third person, the right of the insured to demand compensation from the third person shall be subrogated to the insurer from the time the indemnity is paid. The insured shall furnish the insurer with necessary documents and information that come to his knowledge and shall endeavour to assist the insurer in pursuing recovery from the third person." In art. 253 it states: "Where the insured waives his right of claim against the third person without the consent of the insurer or the insurer is unable to exercise the right of recourse due to the fault of the insured, the insurer may make a corresponding reduction from the amount of indemnity." In art. 254 it is said: "In effecting payment of indemnity to the insured, the insurer may make a corresponding reduction therefrom of the amount already paid by a third person to the insured. Where the compensation obtained by the insurer from the third person exceeds the amount of indemnity paid by the insurer, the part in excess shall be returned to the insured."

of assignment.[47] According to English insurance law and Law of Property Act, 1925 s.136 (UK)[48] the two doctrines have several differences as follows:

(1) Rights of subrogation are vested by the operation of law rather than as the product of an express agreement and can be enjoyed by the insurer as soon as payment is made,[49] while an assignment requires an agreement that the rights of the assured be assigned to the insurer, and an express notice in writing is required to be given to the third party from whom the insured would have been entitled to claim for the loss.[50] In the absence of such notice, the assignment may take effect as an equitable assignment. That has the drawback that the assignee must then call on the assignor to sue the other party but if he will not do so, the assignee can then sue, making the assignor a defendant to the action.

(2) The essence of subrogation is, of course, that the insurers sue a third party in the name of the insured,[51] while the insurer is entitled (and indeed obliged) to sue in his own name under an assignment.

(3) The insurer cannot exercise the subrogation right until the insured is fully indemnified, while the insurer may sue the third party under an assignment before he provides an indemnity to the insured.

(4) The insurer is entitled, by exercising a subrogation right, to recoup only for a loss which he has paid and to the extent of his payment, while he is entitled, under an assignment, to retain any proceeds in excess of those which he has actually paid to the insured.[52]

4.2 The confusion of the two doctrines in the Insurance Law (PRC)

The provisions of the Insurance Law relating to subrogation are, however, a mixture of subrogation and assignment. The reason for this is the confusion of the concepts of the two doctrines. Article 44 para.1 of the Insurance Law states: "Where a third party

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[47] See *Morris v. Ford Motor Co.* [1973] Q.B. 792, 800, 809; *Orakpo v. Manson Investments Ltd.* [1978] A.C. 95, 104.
[48] See Law of Property Act, 1925 [15 Geo. 5, C. 20], s.136.
[49] *Castellain v. Preston* [1883] 11 Q.B.D. 380; *West of England Fire Ins. V. Isaacs* [1897] 1 Q.B. 226.
[50] The Law of Property Act 1925, (U.K.) S. 136.
[51] See, s. 6.2 (2) of this Chapter "Insurer's right against a third party under English law, *infra.*
[52] *Compania Colombiana de Seguros v. Pacific Steam Navigation Co.* [1965] 1 Q.B. 101.

damages the subject matter of insurance, thereby leading to the occurrence of an event insured against, the insurer shall, from the date of payment of insurance monies to the insured, be subrogated to the insured's right to claim indemnity from a third party within the amount of the payment." There are three elements in this paragraph. (1) The loss is caused by a third party and falls within the cover of insurance; (2) The insurer shall be subrogated to the insured's right automatically as soon as the insured has been paid by the insurer under the policy; (3) The insurer is restricted to claiming or suing the third party within the amount he paid out to the insured. These three aspects are completely in conformity with the general rules of the doctrine of subrogation where the insured is fully covered under a policy. However, if the insured is partly covered by the policy, *i.e.* he is an under-insured insured or there is an excess clause in the policy, the aspect of (3) mentioned above is inconsistent with the general rule of subrogation which requires either the insured or the insurer to take action to claim for the whole loss in good faith for his own and the other's benefit. If this paragraph is understood as assignment, aspect (2) mentioned above contradicts the general rule of assignment which requires an assignment agreement between the insured and insurer and also (for legal assignment) an assignment notice to the third party by the insured which is not automatically effected upon the insurer's payment.[53] Thus it could be thought that this article is a mixture of subrogation and assignment because it has both the features of subrogation and assignment.[54] In the following two paragraphs of article 44, it is clearer that this article refers, to large extent, to assignment.

In para. 2 of article 44, it is said: "Where the insured has already obtained indemnity from a third party following the occurrence of an event insured against as mentioned in

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[53] See Law of Property Act, 1925, s.136 (1) [U.K.], it states; "Any absolute assignment by writing under the hand of the assignor (not purporting to be by way of charge only) of any debt or other legal thing in action, of which express notice in writing has been given to the debtor, trustee or other person from whom the assignor would have been entitled to claim such debt or thing in action, is effectual in law (subject to equities having priority over the right of the assignee) to pass and transfer from the date of such notice (a) the legal right to such debt or thing in action; (b) all legal and other remedies for the same; and (c) the power to give a good discharge for the same without the concurrence of the assignor." See also the Contract Law 1999 (PRC) which was adopted on March 15, 1999 at the 2nd Session of the 9th NPC, and made effective as of 1st October 1999. In art. 80, it is stated: "Where the creditor assigns his right (to another person or persons), a notice shall be given to the debtor. Without notification, the assignment shall not become effective to the debtor."

the preceding paragraph, the insurer may, at the time of paying the insurance monies, deduct an amount equivalent to such indemnity obtained by the insured from the third party." It is implied that after the insurer has paid the insured the amount, which is the insured sum minus the amount equivalent to the recovery obtained by the insured from the third party, he has acquired the right of action from the insured to claim against the third party in his own name for the amount he actually paid to the insured. Otherwise the insurer would lose the right of action to claim against the third party in the name of the insured for the amount he paid to the insured, because once the insured has made a settlement with the third party, no matter how he did it, in *bona fide* or with compromise, the settlement is binding on the insurer according to the general rule of subrogation. So from this paragraph, it can be understood that the law vests in the insurer an assignment right rather than subrogation.

In para.3 of article 44, it is stated that "The insurer's exercise of his right of claim by subrogation in accordance with the first paragraph shall have no impact on the insured's right to claim indemnity from the third party for the portion which has not been indemnified." It is obvious that this paragraph refers to the situation where the insured is not fully covered under the policy, such as where the policy contains an excess or it is an under-insurance policy. Under this circumstance, this paragraph means (1) the insurer is entitled to be subrogated to the insured's right to act against the third party after he has indemnified the insured, even if the insured has not received the full compensation; (2) the insured is entitled to retain the right to sue the third party for the part of his uninsured loss. The Insurance Law does not stipulate whose name shall be used when the insurer exercises his subrogation right, but it is implied in this paragraph that the insurer must use his own name to sue the third party for the amount he paid to the insured and the insured uses his own name to sue the third party for the amount of his uninsured loss. They can act independently for their own benefit. In fact, the word "subrogation" in this paragraph has the meaning of assignment. Indeed, according to this paragraph, the insurer and insured sue the third party only by using their own names separately; otherwise, several problems in respect of legal procedure will arise.

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[54] Because both subrogation and assignment permit one party to enjoy the rights of another, they are very similar in this respect, so it is not surprising that some people confuse them.

(1) If the insurer uses the insured's name to sue the third party, and the court makes a judgement, but later the insured brings an action against the third party by using his own name, it must cause a repeated suit for the same cause of action by the same plaintiff and against the same third person, which is not allowed in China's legal procedure.[55] Similarly, if the insured commences the proceedings first for the amount of his uninsured loss, the insurer fails to act in time, and the insured obtains the judgement for his uninsured loss, the insurer will be refused the opportunity to reopen the litigation in the insured's name. (2) If the insured and insurer sue the third party together, and both use the insured's name, it must be strange that for the same cause of action the same two plaintiffs appear in court; (3) If the provision is understood as subrogation, as a general principle, the insurer cannot control the proceedings until the insured has been fully compensated, and the insured must sue in good faith for both his own benefit and the insurer's interest. The third paragraph is therefore superfluous.

However, if article 44 is understood as assignment, and the insurer uses his own name and the insured also uses his own name to sue the third party, the third party will face two claimants, one being the insurer and the other the insured, problems may still arise. Assuming that the insured is not fully covered by the policy, and the third party cannot afford to satisfy their two claims, *i.e.* he can not pay for the whole loss, three situations may occur (1) If the insured acts before the insurer to claim against the third party for the uninsured portion, he can keep all the recoveries without regard to the insurer's interest. (2) If the insurer acts before the insured to claim against the third party for the amount he paid to the insured, he is entitled to keep them all including a surplus, if any, regardless of the insured's right to the uninsured part. If the insured and insurer take action together against the third party, the problem is how does the third party

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[55] See The Law of Civil Procedure 1991 (PRC), art. 111 (5), "Where the litigant starts a second action for a case in which a judgement of ruling has already become legally effective, the litigant shall be informed that the case shall be dealt with as an appeal. ..." In art. 112, it said: " ... If the plaintiff is not satisfied with the court's decision, he may appeal." It is implied that the plaintiff cannot reopen the litigation for the same cause of action once the court has made the right judgement. In England, it is also not allowed to reopen a decided case. For example, if the insured commences proceedings for his own benefit, and obtains judgement against the third party, the insurers will not normally be able subsequently to reopen the judgement on the grounds that the insured did not claim for his insured losses from the third party. See *Hayler v. Chapman* [1989] 1 Lloyd's Rep. 490. Similarly, if the insurer exercises subrogation rights to settle his claim against the third party and signs a form of discharge of the claim which refers to all claims which might arise out of the relevant event, the insured will be bound by

cope with the situation where he does not have enough money to pay the full loss? If they bring an action together with the court against the same third party, how will the court deal with this? According to the Civil Procedure Law (PRC), the insured's and insurer's actions can be dealt with together,[56] but who has the priority to be satisfied with the limited recoveries? These questions will be fully discussed in the next section under the title of "the insured can not make a profit".

In practice, in China, it is even clearer that the two doctrines of subrogation and assignment are confused. A "subrogation" form vividly illustrates this.

The sample of the "Receipt and Subrogation Form" is:

Receipt and Subrogation Form

Loss No.---------- Policy/Certificate No----------

Insured Amount----------

To The People's Insurance Company of China, Qingdao Branch.

Received from The People's Insurance Co. of China, Qingdao Branch the sum of -------- In full and final settlement of the claim under the above mentioned policy/certificate on ---------- Shipped per S/S ---------- From ---------- To ----------

In consideration of having received this payment, we hereby agree to assign, transfer and subrogate to you, to the extent of your interest, all our rights and remedies in and in respect of the subject matter insured, and to grant you full power and give you any assistance you may reasonably require of us in the exercise of such rights and remedies in our or your name and at your own expense.

Date at ---------- This ---------- day of ---------- 19 ----------

Signed----------

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that discharge and unable to reopen the claim. See *Kitchen Design and Advice Ltd v. Lea Valley Water Co.* [1989] 2 Lloyd's Rep. 221.

[56] See the Civil Procedure Law 1991 (PRC), art. 126, it is stated: "Where the plaintiff adds litigant requests, the defendant raises a counter-claim and a third party raises a litigant request related to the case in question, they may be heard in combination." See also Chai Fabang, Minshi Susong Fa (The Civil Procedure Law), pp.156-161. Beijing University Press, 1988.

This is a typical piece of evidence that in China subrogation is confused with assignment. It allows the insurer to take action against the third party by using the insured's name or using his own name to the extent of the insurer's interest. Again, in some books, writers hold the view that subrogation is assignment of creditor's right from the insured to the insurer. Mr Sun said: "subrogation, which is also called assignment, means when the insured loss is caused by a third party, and after payment by the insurer, the insured assigns to the insurer his rights which he enjoys to recover against the third party.[57]

So far as the insured is concerned, assignment is not in his favour, because once the right of the insured against the third party is assigned to the insurer, the insurer can keep any proceeds recovered from the third party. If, for example, there is any prospect of the insured being able to recover more than his actual loss from a third party,[58] the insurer, who had taken an assignment of the insured's rights, would be able to recover the extra money for himself. In article 81 of the Contract Law 1999 (PRC),[59] it is provided that "Where the creditor assigns his right to the assignee, the assignee obtains all rights of the assignor including the incidental rights concomitant with the claim, unless such incidental rights are personal to the creditor."[60] However an insurer who was confined to the rights of subrogation would have not been allowed to retain the surplus, the authority is an English leading case of *Yorkshire Ins. Co. v. Nisbet Shipping Co.*[61] It can be assumed that in *Yorkshire* if the insured had assigned his right

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[57] See Sun Jilu, Baoxianfa Lun (The Theory of Insurance Law), p.117, Chinese Legal Affair Press, 1997. It is noted in China, in lots of books subrogation is called assignment, and in some books they are inter-changeable. See also Yan Xinjian and Shou Jianlu, Zhongguo Baoxianfa Yu Shiwu (Chinese Insurance Law and Practice), p.80, Zhong Xin Press, China, 1996. See also Li Yuquan, Bao Xian Fa (Insurance Law), p.184, Legal Press, 1997.

[58] If the third party is a foreigner, and he pays by foreign currency, there might be a chance that the insured would receive extra money than his factual loss as a result of the fluctuations of exchange rate.

[59] The Contract Law of the PRC was adopted on 15th March 1999 at the 2nd session of the 9th NPC, and effective as of 1st October 1999.

[60] See also The Law of Property Act, 1925 (15 Geo. 5, C.20) s.136 (UK).

[61] [1962] 2 Q.B. 330. In this case, an insured ship was lost in 1945 as the result of a collision and the insurers paid its agreed value of £72,000. With the latter's consent, the insured started proceedings against the Canadian Government, owners of the other ship, and in 1955 the Government was eventually found liable. The damages awarded were some £75,000 which were properly converted into Canadian dollars at the rate of exchange prevalent at the time of the collision. That sum was paid to the insured in 1958, but when it was transmitted to this country and converted into sterling, it produced a sum of some £126,000, because the pound had been devalued in 1949. The insured could not of course deny the insurer's entitlement to £72,000, but disputed that they were entitled to the surplus of nearly £55,000. Diplock J. held that the subrogation rights of the insurers extended only to the sums they had paid out. As Professor Birds comments: "the result is somewhat unfair. After all, the insured had the benefit of

to the insurer, the insurer would have kept the windfall for himself, subject to some collateral bargain to different effect.

Another example is that where an insurance policy contains an excess clause or is an under-insurance, the insurer, under an assignment, will retain all recoveries claimed from the third party without considering whether or not the insured has recovered for his portion which was not covered by the policy, whereas an insurer who was confined to rights of subrogation would pay regard to the insured's interest in respect of the portion which is not covered by insurance. So far as the insurer is concerned, in exercising the rights of subrogation against the third party by using the insured's name, he may avoid the consequence of the publicity, so, for this reason, he prefers to exercise subrogation rights. Another advantage for the insurer in exercising a subrogation right is that the court usually does sympathise with the individual insured, so there is a better chance for the insurer to succeed by using the insured's name, although it is often obvious, in practice, that the "true" claimant is the subrogation insurer.

4.3 Conclusion and suggestions

In conclusion, article 44 of the Insurance Law confuses subrogation and assignment. The application of this article would cause a number of problems in respect of an insurer's and an insured's rights to take action against a third party wrongdoer for their respective interest.

Thus it is suggested that this article should be amended as follows:

(1) "Where a third party damages the subject matter of insurance, thereby leading to the occurrence of an event insured against, the insurer shall, after the payment of insurance monies to the insured, be subrogated to the insured's right to claim indemnity from a third party."

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prompt payment of the money in 1945. It was the insurers who were out of pocket for some 13 years or more. Had the insurer actually exercised their right to sue the Canadian Government in the insured's name, they would probably have been better off because they would have been entitled to claim interest on the money for their own benefit." See J. Birds, Modern Insurance Law, (4th ed.), p. 294, 1997.

(2) "Where an insurer exercises the right of subrogation to recover an amount, he should use the insured's name, and claim the amount for the full loss the insured has suffered. From the recoveries, the insured should have a priority to make up the portion which is excluded from the insurance coverage (such as an excess or under-insurance or average clause), the surplus will go to recoup the insurer's payment to the insured."[62]

5. The Insured can not Make a Profit

As was considered earlier, the justification for subrogation is to prevent unjust enrichment. There are two limbs to this fundamental principle. One limb requires an insured who recovers a sum to compensate for his loss for which the insurer has already made payment to him to repay the insurer and the second limb allows an insurer who has made payment to the insured to pursue, in the name of the insured, any remedy against a third party vested in the insured. The purpose of these two limbs are the same, the rules and qualifications surrounding each limb are, however, different. Thus they merit separate examination. Firstly, let us examine the first limb.

The essence of the first limb is that an insured cannot make profit out of his indemnity insurance contract at the expense of either the insurer or a third party. The authority for this point is the statement made by Brett L.J. in the leading case *Castellain v. Preston* [63], that the insured under an indemnity policy shall be fully indemnified but shall never be more than fully indemnified. The fact of this case was that the insured vendor of a house which was burnt down between the contract and completion recovered money from his insurer for which he was held not accountable to his purchaser. However the purchaser later subsequently completed the purchase and paid the agreed price for the house despite the damage to the house. It was held that the

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[62] However, English common law vests in the insurer the right to be recouped from the subrogation recoveries before the insured get the amount equivalent to an excess stipulated in the policy. See *Napier v. Hunter* [1993] A.C. 713; [1993] 2 W.L.R. 42. This case will be fully discussed in next section of this Chapter.

[63] (1883)11 Q.B.D. 380.

vendor was therefore bound to account to his insurer for the money the latter had paid.[64]

This rule itself has not been disputed during the last hundreds of years, but some rules derived from it have been argued in recent years. Issues arise commonly when the insured's actual loss is greater than the value of his insurance, while the damages recovered from the third party are in fact less than the amount of his actual loss. Either the insurer will fail to recoup the full amount of its payment, or the insured will fail to obtain a full indemnity, or both. The main argument has been focused on the question of whether the insured should be fully indemnified under the insurance policy or completely compensated for the whole loss.[65] This question cannot arise at all if the insured subject matter is fully insured. Problems will arise where the following situations exist: (1) Where the insured is in the position of under-insurance, so that the insured himself bears the under-insured loss. (2) Where the policy contains an excess, so that the insured himself bears the first part of any loss. There are different ways to solve these problems by laws in different countries. In the first place the Chinese situation will be considered, and subsequently references will be made to the English solution and the Australian model and, where necessary, other alternative approaches will also be considered.

5.1 Chinese situation

In China, the Insurance Law does not expressly stipulate the rules about the first limb of subrogation, and there is no express wording to vest in an insurer who has paid the insured the right to get repayment from the insured who recovers a sum from the third party for a loss when the third party is liable for this loss, but the right is implied in some articles of this law. Article 44 para.2 states: "Where the insured has already obtained indemnity from a third party following the occurrence of an event insured against as mentioned in the preceding paragraph, the insurer may, at the time of paying the insurance moneys, deduct an amount equivalent to such indemnity obtained by the

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[64] See also the cases of *Rayner v. Preston* (1881) 18 Ch.D. 1; and *Darrell v Tibbits* (1880) 5 QBD. 560.

insured from the third party." It implies that if the insured recovered from the third party as well as being indemnified by the insurer, he is required to repay the latter, because, in order to prevent the insured from making profit, the law allows the insurer to deduct the amount paid by the third party when the insurer makes payment to the insured. It could follow that if the insurer did not know that the insured had been paid by the third party, and indemnified the insured, the insured is liable to account to the insurer for the surplus after his full compensation for his loss.

Questions may arise where the insured is under-insured or the contract contains an excess clause. However, unlike in England, where the strong disputable question is how to distribute the moneys recovered from the third party if the moneys is insufficient to satisfy the insured's shortfall of the loss (uninsured loss) and the insurer's payment, in China, the question of the distribution of moneys recovered by the insured from the third party is rarely involved. Because, in China, once the insurer pays the insured under the policy, even if the payment is not a full compensation, the insurer is subrogated (assigned) to the insured's right of claim against the third party within the sum he paid (para.1 of art. 44).[66] Thus the insurer and the insured have separate rights to take action against the third party for their own respective benefit if the loss contains insured loss and uninsured loss as provided by para.3 of article 44. In this situation, three questions mentioned above need to be discussed in detail here.

(1) If the insured takes an action before the insurer to claim for the uninsured portion against the third party, can he keep all the recoveries without regard to the insurer's interest? For example, an insured took out insurance for his house under a fire policy, the insured sum was £60,000 with an excess of £10,000. The real value of this house, when it was destroyed by fire, was £80,000. The insurer paid the insured £50,000 under the policy, and then obtained a "Receipt and Subrogation (Assignment) Form"

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[65] The two words between "indemnity" and "compensation" are changeable in some articles, but it needs to be stressed that in this chapter of my thesis, the word "indemnity" means "insurance indemnity under the policy" and the word "compensation" means "the payment for the whole loss".

[66] In England, the point that "an insurer cannot exercise his subrogation right until the insured has been fully indemnified" has caused some dispute as to whether the 'full indemnity' means the full indemnity made by the insurer under the policy or full compensation for the insured's full loss. According to the meaning of article 44 para.1 of the Insurance Law, it is unlikely that such a dispute will be caused because the law vests in the insurer the subrogation rights automatically at the date when the insurer makes the payment within the amount he paid to the insured.

from the insured. The insured claimed against the third party for £30,000 (the excess of £10,000 plus the sum above the insurance limit of £20,000) and his claim was satisfied. The insurer also claimed later for £50,000 against the third party, but he was just able to pay the insurer £10,000 due to financial problems. Can the insured keep all the £30,000 and the insurer retain the £10,000? According to the meaning of article 44, the answer is "yes". This result may not cause much objection, because it is thought to be fair and reasonable for the insured to make up his uninsured loss by recovering damages from a third party who causes the loss.[67]

(2) If the insurer acts before the insured to claim against the third party for the amount he paid to the insured, is he entitled to keep them all including a surplus, if any, regardless of the insured's benefit? The above example is still used here. After having paid the insured and been assigned the insured's right of claim, the insurer takes action first, claiming against the third party for £50,000 (his policy liability) and has obtained that amount. The insured later makes a claim against the third party for £30,000 but has recovered nothing. May the insurer keep all the sum recovered without regard at all to the insured uninsured loss? The Insurance Law implies a positive answer in article 44, because, as was analysed earlier, the insurer's subrogation right vested by the Insurance Law, in fact, is an assignment right, accordingly the assignment rules should be applied that the insurer can keep whatever he recovered from a third party. It is submitted that this should not be the law-maker's intention, but due to the confusion of subrogation and assignment in the Insurance Law, it has to be so interpreted. If the interpretation is correct, it is really not fair for the insured who has no alternative but to bear the uninsured loss himself.

(3) If the insured and insurer claim against the third party together, but for their respective benefits, how does the third party cope with the situation where he is unable to pay the whole loss? if the insured and insurer sue the third party together for their respective benefits, how will the court deal with this? We still take the above example, the third party can pay only £40,000 for the loss, who has a priority to be satisfied from

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[67] In contrast of the English solution that the insured bears the excess for any loss, so he can not obtain the recovery for the excess before the insurer is satisfied, and this was decided in *Lord Napier v. Hunter* [1993] A.C. 713; [1993] 2 W.L.R. 42, which will be discussed in detail soon.

the recovery, the insured or the insurer? Can the recovery be divided between them proportionately or are there any alternative solutions?[68] The Insurance Law does not give any legal provision for these questions. If the questions were submitted to the court, what judgement will be made by the court? There is no answer. However, in China, the people's courts have the function of mediation for some civil disputes,[69] so if there are no laws to be followed or the stipulations of law are ambiguous, or if the parties are willing to be mediated by the people's courts, the function of mediation operates. The people's courts' mediation function may be illustrated through a Chinese case. In *Insurance Company v. Construction Team,*[70] a worker of a construction team under a contract with a film company caused serious fire for this film company when he was working. The insured company claimed against the insurance company for the loss of RMB 800,000. The insurance company indemnified the company and was subrogated to the insured's right to sue the construction team. The team was not able to pay the whole loss due to financial problems. Through the mediation of the People's Court, the insurance company agreed to accept only 30% of the full payment.

Some suggested answers to the above questions have been found from certain textbooks. In one book[71] it is noted that there are three views involved; (1) The insured has the priority to obtain the amount which he has not been paid by the insurer, that is, the full loss minus the amount that the insurer paid for; (2) the insurer should have the priority to be satisfied up to the amount he has paid to the insured; (3) The insurer and the insured shall get their shares by a proportion of the insured loss and uninsured loss.[72]

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[68] The English prevailing law solves this problem by assuming that there are insurances in layers, and each insurance can be recouped by "recover down" principle, *i.e.* the top layer can be satisfied first and then the second insurance and any surplus go to the first insurer. See *Napier v. Hunter* which will be fully considered later.

[69] See the Law of Civil Procedure 1991(PRC), in art. 85, it is stated: "Where a civil case it has accepted can be mediated, the People's Court shall resolve it through mediation on the basis of the litigant's voluntary participation and by ascertaining the facts and distinguishing right from wrong."

[70] See Zhu Tao and Wang Baoshu, Qiye JingJi Jiufen Dianxing Anli Tonglang (The selected cases for the commercial disputes), p. 724, The Enterprise Administration Press, Beijing, 1995.

[71] See Fu Anping and Fan Hua, Zhonghua Renming Gongheguo Baoxianfa Shiwu Qanshu (The Practical Book for the Insurance Law of the PRC), pp. 21-23. 1995.

[72] The third view that the insurer and insured shall get their shares by a proportion of the insured loss and uninsured loss is based on the contribution rule which is provided in art. 39 para.3 of the Insurance Law , it is stipulated: "Where the sum insured is less than the insured value, the insurer shall assume indemnity liability in accordance with the proportion of the sum insured to the insured value, unless the contract provides otherwise." This provision applies only to the indemnity where the policy is an under-

According to the above analysis, it can be seen that the Insurance Law does not favour the insured. Indeed, to some degree it could be said that it is not fair to the insured. As was examined earlier, the fundamental rule of subrogation is to prevent unjust enrichment, and it could be argued that, before the insured obtains the compensation in full for the loss he actually sustained, he cannot be said to be unjust enriched. The only possibility for the insured to make a profit is by a double payment from the insurer and the third party. If there is no such possibility, the insured has no chance to make a profit, and the insurer therefore is not entitled to exercise his subrogation right. As is said in MacGillivray, the insurer's right of subrogation is the corollary of two fundamental principles of common law: (1) If a person suffers a loss for which he can recover against a third party, and is also insured against such a loss, his insurer cannot avoid liability on the ground that the assured has the right to claim against the third party. (2) Conversely, the third party, if sued by the assured, cannot avoid liability on the ground that the assured has been or will be fully indemnified by the insurer for his loss.[73] Accordingly, there is the possibility for the insured to be paid doubly by the insurer and the third party upon which the principle of subrogation was created. However, there is no doubt that the possibility of overlap payment for the loss may only be caused within the insurance coverage, for which the insurer has liability to pay the insured and the third party also has to pay if he is held liable, otherwise, for any uninsured loss, there is no possibility at all for the insured to get double payment because the insurer has no liability to pay for an uninsured loss and the only possibility of compensation is the third party's payment. It therefore could be suggested that if the loss caused by the third party includes insured loss and uninsured loss, after the insurer has paid the insured for the insured's loss, the insurer has the right to sue the third party for the whole loss. Where the recoveries from the third party are not sufficient to satisfy the insured for his uninsured loss and the insurer for his payment to the insured, the insured should be entitled to be paid for his part of the uninsured loss from the recoveries before the insurer is recouped.

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insurance but is not designed for the distribution of subrogation recoveries. However, it is submitted that this principle may be used to deal with the problems which arise in subrogation before further relevant provisions are drafted.

It should be noted that, although the questions derived from the Insurance Law do not directly involve the distribution of the recoveries, they are, in essence, very similar to the question of the distribution of recoveries which was strongly disputed in England for a long time and which was solved recently by the leading case of *Lord Napier v. Hunter*[74], so it is now appropriate to consider the English law relating to this question here.

5.2 The English solution

(1) Excess clause

The rule that the insured cannot make a profit from his loss has long been established in England. The leading illustration here is still *Castelain v. Preston*[75] which was examined above. However, the application of it is subject to the limitation that the insured must be fully indemnified.[76] A question then arises as to whether the insured must merely be fully indemnified within the terms of the policy before the duty to account to the insurer arises, or whether he must be fully compensated for his whole loss. Until recently, there were no clear answers to this question in any decided English cases. The typical case of *Napier v. Hunter*[77] gave an authoritative answer to this question. It is necessary to describe the case here. The insureds were members of a Lloyd's syndicate who in effect reinsured the risks they had agreed to bear by insuring with "stop loss" insurers (this is in fact a reinsurance case). The policy contained both an excess clause and an agreed limit on liability. The syndicate suffered a loss and recovered on the policy. The members also sued their own managing agents who caused the loss by breaching contract and by negligence. A settlement was reached with those agents and the settlement moneys were held by a firm of solicitors. The main purpose of the proceedings between insurer and insured was to establish the respective claims on these moneys given that these were

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[73] See MacGillivray on Insurance Law, 9th ed, p.531, para.22-2, 1997.
[74] [1993] A.C. 713; [1993] 2 W.L.R. 42.
[75] [1883] 11 Q.B.D. 380.
[76] See *Scottish Union & National Insurance Co. v. Davis* [1970] 1 Lloyd's Rep. 1.
[77] [1993] A.C. 713; [1993] 2 W.L.R. 42.

insufficient to meet the totality of the insured and uninsured losses.[78] On this issue the House of Lords decided that the insured should stand behind the insurer so far as recovery in respect of the excess was concerned. In this case, the loss suffered by the insured was £160,000. The limit of the insurer's liability, that is the sum insured, was £125,000, and there was an excess of £25,000. The sum recovered from the third party responsible for the loss was £130,000. The insurers paid the insured £100,000, that is the sum insured less the excess. The question was how to distribute the moneys of £130,000 recovered from the third party. In this situation, Lord Templeman determined that the order of the distribution could be dealt with by assuming that there were in fact three insurers to bear the liability, the first bore liability for the first £25,000 of any loss, the second was liable for the next £100,000 and the third was obliged to pay for the loss above the £125,000. On the loss of £160,000, the insured would recover £25,000, £100,000 and £35,000 from the respective insurers. On the recovery of £130,000, £35,000 would first go back to the third insurer as he assumed this risk only if the other two insurers were insufficient. The second insurer, the stop loss insurer, would then be entitled to the remaining £95,000 which would exhaust the settlement moneys. There was insufficient money to be recovered by the first insurer under the excess.

Another view in this case for the distribution of the recovery moneys was made by Lord Jauncey. He expressed the matter somewhat differently but with the same result. The reasoning of Lord Jauncey was "When an insured loss is diminished by a recovery from a third party, whether before or after any indemnification has been made, the ultimate loss is simply the initial loss minus the recovery and it is that sum to which the provisions of the policy of assurance apply including any provision as to an excess." Accordingly, the insured's ultimate loss is £160,000 (the initial loss) less £130,000 (recovery moneys from the third party) making a total loss of £30,000. The policy contains an excess of £25,000 which the insured agreed to bear. The stop loss insurer therefore need only to pay £5,000. So he can recoup from the recovery moneys £95,000.

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[78] The other issue, as was mentioned above, was whether the insurers were entitled to exercise any proprietary rights by way of trust or lien over the moneys. On this issue the House of Lords decided that the insurers had an equitable lien over the moneys.

It could be concluded from the decision of *Napier* that in England, where the policy contains an excess for which the insured bears the risk himself, the insurer has priority to be recouped for his payment from the moneys recovered from the wrongdoer as opposed to the insured's chance of recovering his excess. Their Lordships' analysis and reasoning are very logical and it is difficult to fault. However, it is not free from criticism. On the one hand, it was argued that it is hard to disagree with the result in a situation involving commercial insurance where it must perhaps be assumed that the parties are fully aware of the significance of an excess clause. However, in other contexts it may not be so easy to rationalise the result by saying that the insured agreed to bear the amount of the excess. At least some insureds do not in reality so agree. In many classes of insurance, they have no choice as to whether or not there is to be an excess, although in some they may have a choice as to the amount of the excess.[79] On the other, it is also argued that none of this is to deny that it may well come as an unpleasant surprise to many insureds to discover that the effect of the excess clause in their policies is to prevent them from recovering in respect of their uninsured losses from third parties until after their insurers have recouped their payments.[80]

As another commentator argues[81] "The issue by the House of Lords in *Napier v. Hunter* was seen not as one of unjust enrichment but as one of contract and the assumption of risk. As a matter of contract, the insurer has promised indemnity only in respect of loss greater than the excess. If the insured's actual loss is 10X, the excess is 2X, and the insurer pays 8X, but then the insured recovers 6X from a third party, the insured's actual loss (insurance money apart) has shrunk to 4X (10 minus 6). In these circumstances, the insurer's obligation, had he not paid already, would have been to pay only 2X (4 minus the excess of 2) and, having paid 8X, the insurer should recover 6X, leaving the insured with a final net loss of 2X (the excess) not, as held at first instance, a recovery of 4X, leaving the insured without loss. Is this really what both parties intended? Can one really say that this was a risk assumed by the insured, when one of the main reasons for taking insurance is to avoid risk and to avoid loss? The

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[79] Birds, Modern Insurance Law, (4th ed.), P.292, 1997

[80] Charles, The Law of Subrogation, p.85, Clarendon Press. Oxford, 1994.

[81] See Professor Malcolma Clarke, The Law of Insurance Contracts, (3rd ed.), p.808, 1994.

excess is stipulated not by the insured but by the insurer, to reduce transaction costs and to encourage the insured to be risk averse. Without an excess, the cover would cost more, so the insured does agree to bear that layer of risk but only because he cannot cover it without disproportionate expense. Does it follow that, if compensation is available from the wrongdoer, he intends it to go (top down) to the insurer first?"

It is submitted that all the above arguments are convincing. Indeed, when the insured effects a policy which contains an excess clause, both the insurer and insured have no intention of depriving the insured of his right to obtain a recovery from another source for the excess loss, although none may deny that the insured himself bears the risk under the excess where there is no third party involved. For instance, the loss is either caused by the insured himself due to negligence or caused by a natural disaster, but if the loss is caused by a third party, the insured must hope to recover the loss for the excess from the third party rather than being willing to bear the loss himself. It might be thought that the result of *Napier* is acceptable in England where people know insurance better although there is much criticism of it. However people in China would be surprised to find out that they were prevented from recovery in respect of a loss for the excess from a third party who caused their loss and to know that such a recovery would eventually go to the insurer's hands.

(2) The under-insurance position

Strictly speaking, *Napier* was concerned only with the effect of an excess on subrogation recoveries. However, it is possible to apply the reasoning in this case of the "recover down" principle, to argue that the under-insured insured is merely his own insurer for this "top" layer of loss above the policy limit. In this way such an insured has first call on any recovery moneys (in fact, in *Napier*, the insured did have the first call of £35,000 from the recovery of £130,000) although there is a contrary argument,[82] because he only agreed to pay if the first insurance did not cover the total loss.

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[82] See Birds, Modern Insurance Law, (4th ed.) p.292, 1997.

According to s. 81 of the MIA 1906 (U.K.), under-insurance is defined as "Where the assured is insured for an amount less than the insurable value or, in the case of a valued policy, for an amount less than the policy valuation. He is deemed to be his own insurer in respect of the uninsured balance." Under this circumstance, the insured himself should be the second insurer if the insurance is arranged by layers subject to the way treated in *Napier v. Hunter*[83] where the insured bore the loss only when the first insurance cover proved insufficient. In this way such an insured has first call on any recovery moneys by the reasoning in *Napier* and the "recover down" principle. The issue of subrogation upon an under-insurance also arose in *Commercial Union Assurance Company v. Lister,*[84] a case which is usually cited as authority for the proposition that an insured not fully compensated for his loss retains control of legal proceedings brought against a third party. In this case L had insured his mill with 11 insurers for a total of £33,000. The mill was destroyed in a gas explosion, the responsibility for which lay with the Halifax Corporation. L's estimated true losses exceeded £56,000, including consequential loss of profits of £6,000. L recovered under the policies and sued the corporation. The insurers sought a declaration that they were entitled to the benefit of any right of action and that L might be restrained from suing other than for the total loss. Sir George Jessel M.R. held, on an interlocutory application by Commercial Union, that the insured could retain control of the action subject to an undertaking to sue for the whole loss. Of interest is the further comment, said to be an indisputable proposition, that once the insurer paid out "if the insured obtains from the corporation of Halifax a sum larger than the difference between the amount of the insurance and the amount of the loss, he is a trustee for that excess for the insurance company or companies..."[85] The implication of Sir George Jessel M.R's. statement seems to be that recovery in the situation of under-insurance should go first in favour of the insured in respect of his losses not covered by the policy. This conclusion is supported by the marine insurance case of *Sea Insurance Co. v. Hadden*,[86] a case strictly on abandonment but supportive of this result.

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[83] [1993] A.C. 713; [1993] 2 WLR 42.
[84] (1874) L.R. 9 Ch.App. 483.
[85] *Ibid*, per Sir George Jessel M.R. at 484.
[86] (1884) 13 Q.B.D. 706.

The decisions considered above for subrogation in an under-insurance situation are in conformity with the justification of the principle of subrogation which was established by Brett L.J. in the classic leading case of *Castellain v. Preston.* Brett L.J. said: "The very foundation, in my opinion, of every rule which has been applied to insurance law is this, namely, that the contract of insurance contained in a marine or fire policy is a contract of indemnity, and of indemnity only, and that this contract means that the assured, in case of a loss against which the policy has been made, shall be fully indemnified, but shall never be more than fully indemnified. That is the fundamental principle of insurance, and if ever a proposition is brought forward which is at variance with it, that is to say, which either will prevent the assured from obtaining a full indemnity, or which will give to the assured more than a full indemnity, that proposition must certainly be wrong."[87] Although Brett L.J. did not concern matters of an excess clause or under-insurance in *Castellain v. Preston*, it could be concluded that an insured can not be said to be unjustly enriched before he obtains a recovery for his total loss. By this reasoning, the insured has a first claim on any proceeds recovered from a third party to the extent required to achieve a full indemnity before the insurer is reimbursed. This view was supported by O'Connor M.R. in *Driscoll v. Driscoll*[88], he remarked when he upheld the insured's contention: "I now come to the claim of the Insurance Company. That is based on the right of subrogation, and the contention of the Company is that whatever sum is recovered by the insured must go to recoup the Company the amount paid on foot of the policy, irrespective of the consideration of whether the insured has been fully indemnified against the loss sustained. This is met by the insured's contention that until he is fully indemnified he is not bound to contribute anything to the Company. I have no doubt that this latter view is correct. A contract of insurance against fire is only a contract of indemnity, and I think that the foundation of the doctrine of subrogation is to be found in the principle that no man should be paid twice over in compensation for the same loss. The corollary to this is that a contract of indemnity against loss should not have the

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[87] (1883) 11 Q.B.D. 380, at 386.
[88] [1918] 1 Ir. R. 152.

effect of preventing the insured from being paid once in full. I do not think that this can be disputed."[89]

5.3 Other alternative approaches

For the distribution of the recovered moneys, there are other approaches different from the English solution. The general rule of the other alternative approaches is that the insured has priority with respect to the moneys recovered from the third party where the insurance contract is inadequate to meet his full loss sustained (or the general rule is that the insured has a first claim on any damages recovered from a third party to the extent required to achieve a full compensation). This logical principle is well established in some other countries by case law or statutes.

Several Canadian decisions are worth considering here. In *National Fire Insurance Co. v. McLaren*[90], it was stated: "In cases of insurance where a third party is liable to make good the loss, the right of subrogation depends upon and is regulated by the broad underlying principle of securing full indemnity to the insured, on the one hand, and on the other of holding him accountable as trustee for any advantage he may obtain over and above compensation for his loss…The primary consideration is to see that the insured gets full compensation for the property destroyed and the expenses incurred in making good his loss. The next thing is to see that he holds any surplus for the benefit of the insurance company."

Another authority is *Ledingham v. Ontario Hospital Services Commission*[91], a decision of the Supreme Court of Canada on appeal from the Ontario Court of Appeal. The facts, in brief, are that the plaintiffs were injured by a third party in a vehicle accident.

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[89] *Ibid,* at 159. See also some Canadian cases which supported this view, for example, *Globe & Rutgers Fire Insurance Co. v. Truedell* [1927] 2 D.L.R. 659; *Ledingham v. Ontario Hospital Services Commission* (1974) 46 D.L.R. (3d) 699. This rule follows automatically if one accepts the view, adopted by Canadian courts, that there is no enforceable right of subrogation until the insured has received a full indemnity. However it is not necessarily consistent with the theory that an enforceable right of subrogation arises upon payment by the insurer of the amount required by the policy, if it is accepted that this merely entitles the insurer to compel the insured to lend his name to an action against the third party.

[90] (1886) 12 D.L.R. 683 at 687.

[91] (1974) 46 D.L.R. 699.

The Hospital Services Commission made payment to the insureds. Two actions for damages for personal injuries were brought against an uninsured defendant who paid a sum which was less the whole claims. The Hospital sought to exercise rights of subrogation pursuant to the Regulation under the Hospital Services Commission Act which provided, *inter alia*:[92] "...the Commission is subrogated to any right of an insured person to recover all or part of the cost of insured services from any other person, including future insured services, and the Commission may bring action in the name of the insured person to enforce such rights. ... An insured person, who commences an action to recover for loss or damages arising out of the negligence or other wrongful act of a third party to which the injury or disability in respect of which insured services have been provided is related, shall include a claim on behalf of the Commission for the cost of the insured services." The Supreme Court held that no special meaning could be given to subrogation as none was expressed in the statute. It was held that the subrogation had the ordinary meaning assigned to it by equity and that it followed that the Commission had no claim until the insured persons had recovered complete indemnity from the wrongdoer, and that where the wrongdoer had no insurance and where the claims of the injured person from the fund exceed the limit, there is less than an indemnity to them and no unjust enrichment or other equity capable of supporting a claim by the commission to share *pro rata* with them.[93]

In some more recent Canadian cases, this approach has been approved. In *Confederation Life Insurance Co. v. Causton* [94] it was observed that it "would be patently unfair to deny the insured all his rights and remedies respecting the loss when he had not been fully indemnified for the loss." Similarly in *Bigl Estate v. Alberta*[95] it was found that a "plaintiff is not to be unjustly enriched by an overpayment but he is entitled to full payment before the subrogation claimant is paid anything." In all the above cases, the rule that the insured has the priority to be fully compensated from the recovered moneys paid by the third party is strongly approved and supported.

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[92] The Regulation 443, s.55 (2) and (4), under the Hospital Services Commission Act of Canada, R.S.O. 1970.
[93] (1974) 46 D.L.R. 699, at 701.
[94] (1989) 60 D.L.R. (4th) 372, at 375 per Wallace J.A. (Court of Appeal of British Columbia).
[95] (1989) 60 D.L.R. (4th) 438, at 441 per Laycraft C.J.A. (Court of Appeal of Alberta).

Another model is the Australian approach. In Australia, the ICA 1984 (Australia), section 67 deals with the matters with respect to the destination of subrogation recoveries. The general rule is set out in this section: "Where an insurer, in exercising a right of subrogation in respect of a loss, recovers an amount, the insured may recover that amount from the insurer. (2) Unless the contract expressly provides otherwise, the insured may not recover under subsection (1): (a) an amount greater than the amount (if any) by which the amount recovered by the insurer exceeds the amount paid to the insured by the insurer in relation to the loss; or (b) an amount that, together with the amount paid to the insured under the contract, is greater than the amount of the insured's loss."[96] This section vests in the insured the right to be given the moneys from the insurer who, if successful, recovers moneys from the third party by exercising the subrogation right. Moreover, section 67(2)(a) allows the insured to get the amount of the difference (if any) between the amount recovered by the insurer in the subrogation action against the third party and the amount already paid by the insurer to the insured in relation to the loss, that means if there is any thing in excess of the loss, the surplus goes to the insured. Section 67(2)(b) then further provides that the insured may recover from the insurer's subrogation recoveries an amount, together with the amount paid to the insured under the contract, up to the amount of the insured's loss. Accordingly, the insured has the right to make up the shortfall for the uninsured loss if the insurance is an under-insurance or there is an excess in the policy. Thus section 67 is designed to ensure that the insured may participate in any subrogation recovery to the extent necessary to achieve a full indemnity for his loss, or he may get a surplus, if any. It must be noted that section 67 only becomes relevant when the proceeds of any judgement obtained against the third party have been paid directly to the insurer rather than to the insured. The ICA 1984 does not deal with the matters of distribution of recoveries which are held in the insured's hands. Thus it was suggested that the rules developed by the courts with respect to the distribution of recoveries by the insurer should also apply to the situation where the insured recovered from the third party.[97] It is a big progress that section 67 of the ICA 1984 allows the insured to recover the proceeds from the hands of the insurer who was paid directly by the third party, and it

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[96] It is noted that the reference to the amount recovered by the insurer refers to the amount actually recovered from the third party less the insurer's administrative and legal costs incurred in connection with the recovery. See s. 67(4) of the Australian ICA 1984.

also gives the insured the priority to make his full compensation for his loss from the subrogation recoveries before the insurer recoups his payment.

5.4 Conclusion and suggestions

The Chinese Insurance Law does not make express provisions in respect of the first limb of the doctrine of subrogation. There are no rules regarding distribution of the recoveries from the third party in the case of under-insurance and an excess clause. Thus many problems will arise in practice as discussed above and these problems can also give rise to difficult situations for the court in deciding who has the priority to the recoveries.

In England, the prevailing solution for the distribution of the recovered moneys from the third party is the decision of *Napier,* in which the insurance is treated by layers and the recovered money is distributed on the "recover down" basis. The reasoning of this decision is very logical and is really difficult to fault, but as Professor Clarke comments,[98] the issue in this case was not focused on the fundamental rule of subrogation of preventing unjust enrichment but on the analysis of the assumption of risk. If turning the issue on the former, it would not be difficult to say that the decision is not satisfactory because it is not in harmony with the justification of the principle of subrogation that was created to prevent unjust enrichment.

Comparatively, the alternative Canadian approach and Australian approach are fairer because they give the insured a priority to be satisfied from the proceeds recovered from the third party provided that the insured does not make profit from the compensation. It is suggested that the Canadian and Australian approaches are suitable for the Chinese situation, *i.e.* in any event, including an excess or under-insurance, the insured should get full compensation before the insurer is recouped from the third party's payment. The English solution in respect of the under-insurance, rather than the excess clause, is also considered to be reasonable and may be taken as a reference for amending the Chinese Insurance Law. The Australian design of section 67 that the

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[97] For the detailed analysis for this point see Derham, Subrogation in Insurance, pp.141-143, 1985.
[98] Clarke M.A. The Law of Insurance Contracts, 2nd ed. P.808, 1994.

insured has the right to participate in any subrogation recovery paid directly to the insurer is also worth following. Generally speaking, it is suggested that Chinese Insurance Law should be amended for the purpose that the insureds should be more protected than the insurers, at least for the moment, because most Chinese people do not fully understand insurance.

6. The Insurer's Right against a Third Party

Having considered the first limb of subrogation above, now let's turn to examine the second limb, *i.e.* the insurer is entitled to stand in the insured's shoes on payment to sue the third party.[99] The insurer's right to bring proceedings in the name of the insured is long established in England. In *Mason v. Sainsbury,*[100] Lord Mansfield said "Every day the insurer is put into the shoes of the assured." It has been recognised that the insurer is subrogated to all the rights of the insured against a third party, be it in respect of a right in tort, contract or in accordance with an applicable custom or usage.[101] There are different rules in different countries on the application of the second limb of subrogation. The Insurance Law puts more attention on the second limb of subrogation than on the first one.

6.1 The application in China

(1) The pre-requisite for exercising the right

One important limitation for the insurer to exercise his subrogation right is that he must first pay the insured. This rule is clearly adopted by the Insurance Law. In para.1 of

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[99] However, it is important to note that, in MacGillivray, there is a new theory being found for the second limb of subrogation. It is said that the doctrine of subrogation confers two distinct rights on the insurer, these are the right to oblige the assured to pursue remedies against third parties for the insurer's ultimate benefit, (this in fact refers to second limb of the subrogation, namely the right of the insurer to sue the third party by using the insured's name), and the right to recover from the assured any benefits received by the assured in extinction or diminution of the loss for which he has been indemnified. It is continued that (in footnote) adherents to the "equitable" theory of the origins of subrogation might prefer to describe the right of suit as being exercised by the insurer in the assured's name, but this is, strictly, incorrect. See MacGillivray, (9th ed.), p.545, para.22-35 and Note 20.

[100] (1782) 3 Doug. K.B. 61 at 64.

[101] *Tate v. Hyslop* (1885) 15 Q.B.D. 368.

article 44 it states: "Where a third party damages the subject matter of insurance, thereby leading to the occurrence of an event insured against, the insurer shall, from the date of payment of insurance moneys to the insured, be subrogated to the insured's right to claim indemnity from a third party within the amount of indemnity." It is clear that the exercise of the insurer's subrogation right vested by the law has two limitations. (1) the insurer must pay before he is subrogated to the insured's right of action against a third party. Once the payment is made he is entitled to start the action immediately and automatically and does not need the insured's authorisation. (2) the insurer's claim amount against the third party is limited within the amount of the payment. It is not difficult to find that this provision is self-contradictory if the insured's loss contains an insured loss and an uninsured loss, because, where the insurer pays the insured only the insured loss, and claims against the third party, the third party will not know how much he needs to pay to the insurer. In this case, a "Subrogation Form" (in fact, it is an assignment agreement although it is called subrogation form) is necessary to show how much the insurer has paid to the insured, but it is implied in article 44 that no such an agreement is needed.

As to the first qualification for the insurer's subrogation right, there are some arguments on the question that whether the insured has to make claim and take legal action against the third party who caused the occurrence of the insured event before submitting a claim to the insurer. Some commentators think that "if the insured event is caused by a third party, the third party is obliged to pay the insured, while the insurer may be relieved from his liability in this case. However, the insurer may pay the insured if the third party can not afford to pay the insured."[102] From this point of view the doctrine of subrogation would have never occurred. Others consider that "where the insured event is caused by a third party, the insurer may pay the insured in advance if the insured makes claim against the insurer, provided that the insured has made claim against the third party and agreed to transfer the subrogation right to the insurer. The insured's claim against the third party must be made in writing, but he does not have to sue the third party as a pre-requisite for the payment by the insurer."[103] It is submitted both these two views are not in conformity with the Insurance Law which

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[102] This view was cited by Zhou Yongsheng in his book of Insurance and Law, p. 171, 1998.
[103] See Zhou Yongsheng, Baoxian Yu Falu (Insurance and Law), p. 173, 1998.

does not impose such extra duties on the insured nor with nature of the doctrine of subrogation.

The second qualification for the insurer's subrogation right stipulated in article 44 that the amount which the insurer may claim against the third party is limited within the amount of his payment to the insured under policy seems not in agreement with the general rule of subrogation that either the insured or the insurer should act against the third party for the whole loss for both his own benefit and the other's. So it is submitted that the Insurance Law should remove this qualification and give the insurer the right to claim the whole loss against the third party for both himself and the insured's benefits. Following this, another important question arises, *i.e.* whose name will be used when the insurer exercises his subrogation right against the third party.

(2) Whose name is used

The rule that insurers sue in the insured's name as a general rule has long been established in England.[104] However, in China, insurance laws and regulations have never given any provision on this point. Due to the absence of the stipulation on this point in Chinese insurance laws, confusion has been caused both in law and in practice. Article 44 para.3 of the Insurance Law stipulates that the insurer's exercise of his subrogation right shall have no impact on the insured's right to claim against the third party for the portion which has not been indemnified. As has been already discussed, the rule described in para.3 can only be achieved by both the insurer and the insured using their own names separately. If the insurer does it by using the insured's name, and the insured does it by using his own name, many problems will arise as were discussed above.[105] Firstly it may cause duplicate legal action and secondly it may cause the third party to be confused and inconvenienced.[106] If the insurer claims against the third party in his own name, a "subrogation (assignment) form" is necessary

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[104] See *Mason v. Sainsbury* (1782) 3 Doug. K.B. 61. Compare the American approaches, in most parts of the United States an insurer exercising a right of subrogation is required to sue in its own name. See *Home Insurance Co v. Pinski Brothers Inc.* (1972) 500 P (2d) 945.

[105] See s. 4.2 of this Chapter "The confusion of the two doctrines in the Insurance Law" *supra.*

[106] If the insurer uses the insured's name to claim, the third party may think that it is the final settlement for the insured's loss, but if the insured later claims against the third party by using his own name, the

although para.1 of article 44 does not so imply. If the insurer claims without such a form, the third party may refuse to pay on the ground that he has nothing to do with the insurer.[107] Subsequently, in practice, a "mixed form" of subrogation and assignment has been used for a long time. This allows the insurer to exercise his subrogation right by using either the insured's name or his own name (as was shown earlier). However, as a matter of practice, in most cases, the insurer exercises his right by using his own name.

As to the questions of whose name is used when the insurer exercises his subrogation right against the third party and for what amount the insurer may claim against the third party, different views have been found in books and articles in China. Some insist on using the insurer's own name, as Professor Xu comments: "After obtaining the subrogation right, the insurer shall claim against the third party using his own name. Although the Insurance Law does not stipulate whose name shall be used in the exercise of the subrogation right, in theory subrogation is in essence an assignment of the creditor's right, the insurer will be the new creditor upon the assignment of the insured's right, he therefore should sue the third party in his own name. If the insurer sues in the insured's name, it will be an action of agency (this means that the insurer will act as an agent of the insured to claim against the third party) but not subrogation."[108] Some others submit that "the insurer may use the insured's name to claim against or sue the third party and share the money recovered from the third party

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third party will be confused as to why the insured is claiming again when he has already paid the insured. Thus it must cause some inconvenience to the third party, which is unfair to him.

[107] Where a wrongdoer damages the insured's subject matter of insurance, it may be caused either by a breach of contract or by tort, but he is liable to pay damages to the insured no matter what the cause is, according to the Civil Law. Art. 111 of the Civil Law provides: "If a party fails to fulfil its contractual obligations or violates the terms of a contract while fulfilling the obligations, the other party shall have the right to demand fulfilment or the taking of remedial measures and claim compensation for its losses." Art. 117 states: "Anyone who damages the property of the state, a collective or another person shall restore the property to its original condition or reimburse its estimated price. If the victim suffers other great losses therefrom, the infringer shall compensate for those losses as well." Accordingly, the wrongdoer is liable to pay the insured for whom he causes a loss. There is really no relationship between the wrongdoer and the insurer. If the insurer claim against the wrongdoer by using his own name and without a necessary assignment form, the wrongdoer must refuse him. So the insurer must use the insured's name to do so.

[108] See Xu Xuelu, Baoxianfa (Insurance Law), p. 157, 2000. See also Li Zhengming and Jia Linqing, Haishang Baoxian Hetong de Yuanli and Shiwu (The Principle and Practice of the Marine Insurance Contracts), p.88, University of Politics and Law of China Press, 1994. See also, Li Yuquan, Bao Xian Fa (The Insurance Law), p.187, Legal Press, China, 1997.

with the insured."[109] Some writers also insist on the insurer using the insured's name.[110] Although there are so many views on this question, in practice the insurer usually exercises his subrogation right by using his own name. However, in my own opinion, when the insurer exercises his right of subrogation he should use the insured's name and claim for the full loss and the recovery should be distributed between the insured and the insurer according to the rule that the recoveries make up the insured's shortfall first and then recoup the insurer,[111] otherwise problems may be caused as discussed earlier.[112] Thus another question may arise, that is, when is the insurer entitled to control the proceedings if he sues by using the insured's name?

(3) When the insurer may control the proceedings

Article 44 para.3 of the Insurance Law implies that after the payment by the insurer but not full compensation, neither the insurer nor the insured may control the proceeding. The insured is free to sue the third party for his uninsured loss even if he has been indemnified by the insurer under the policy but if it is not full compensation, the insurer has no right to stop the insured.[113] The insurer, upon payment to the insured, may start an action immediately against the third party for the insured loss he has paid to the insured, and the insured has no right to stop the insurer from doing so. Each party may act independently without the other's intervention and they then are separate creditors against the third party. As has been discussed above, in China, the application of the principle of subrogation either in law[114] or in practice[115] is, in fact, a mixture of subrogation and assignment. Problems caused by this have been discussed earlier. Under these circumstances, it is suggested that the insurer may take over the

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[109] See Jia Youtu and Li Guilian, Baoxianfa Gailun (Introduction to Insurance Law), p. 146, 1995; see also Bian Yaowu and Li Fei, Zhonghua Renmin Gongheguo Baoxianfa Shiyi (Brief interpretation on the Insurance Law of the PRC), p. 97, 1996. See also Yu Xinnian, Zuixin Baoxianfa Tiaowen Shiyi (The Most Current Interpretation on the Insurance Law), p. 114, 1995.

[110] See, Yan Lixin, Baoxian Peishang Shiwu (The Practice of Insurance Settlement), p.199, 1997.

[111] The insured's shortfall here is referred to as under-insurance loss and under an excess clause. It is suggested that the insured should be fully compensated for the full loss before the insurer recoups any recoveries

[112] See s. 4.2 of this Chapter "The confusion of the two doctrines in the Insurance Law, *supra*.

[113] See para.(3) of art. 44 of the Insurance Law.

[114] See art. 44 of the Insurance Law.

[115] As is shown by the subrogation form (assignment form) which is used by the insurance companies in China in practice. In this form, it states that the insurer is subrogated, assigned or transferred to the insured's right to sue the third party by using the insured's name or his own name.

right of controlling the proceedings and start to exercise his subrogation right against the third party by using the insured's name if the insured so agrees upon payment under the policy, but he must sue for the whole loss the insured has suffered from, and for both himself and the insured's benefits. Alternatively, if the insured, who has been paid by the insurer under the insurance policy, but not a full compensation for the whole loss, wishes to control the proceedings, he may retain the right to do so, but he must also conduct *bona fide* for the full loss and with the consideration of the insurer's interest. Indeed, it does not matter who controls the action upon the payment by the insurer under the policy, provided they conduct *bona fide* in the interests of both parties. In adopting this approach, there are several advantages for both the insured and the insurer. (1) So far as the insureds are concerned, in China, lots of insurance consumers are individuals, who do not have lots of legal knowledge and insurance knowledge, so they do not really know how to sue wrongdoers who cause an insurance loss. If an insured allows his insurer to stand in his position and use his name to conduct against the third party, this problem will be solved. So far as the insurer is concerned, after payment he can start an action immediately against the third party and does not need to obtain an assignment agreement filled in and signed by the insured, and thus can secure the time limit. (2) This approach may simplify matters. In general, the fewer parties who are involved in an action, the simpler the procedures will be that are taken. For example, if the insurer sues by using the insured's name, just two parties, the insured and the third party, would be involved in legal procedures. Otherwise there are at least three parties involved,[116] and this must complicate the situation which must cause more difficulty for the third party and the court to deal with. Whether or not the insurer may control the proceedings before he has indemnified the insured under an express subrogation clause stipulated in a policy is another question which will be considered later under the title "contractual subrogation".

6.2 The insurer's right against a third party under English Insurance Law

(1) The insured must be indemnified

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[116] If the insurance is a co-insurance, more parties will be involved.

The insurer is subrogated to any claim of any character for which the insured is entitled to bring proceedings against a third party to diminish his loss.[117] However he can not take any action against a third party before he has paid the insured under the policy. This point was illustrated by the case of *Page v. Scottish Insurance Corporation*[118] In this case, P, while driving F's car, negligently collided with and damaged T's car, as well as damaging F's car. F's insurers instructed P to have F's car repaired, but refused to pay these costs and, before indemnifying P against the claim of T, claimed to have the right to sue P in the name of F for damages for negligently driving F's car, and to be able to set off against the repair costs the damages payable to T. The Court of Appeal held that the insurer's exercise of their subrogation rights in F's name was premature: "The underwriter has no right to subrogation unless and until he has fully indemnified the insured under the policy."[119] Unfortunately, this case did not make the point clear, *i.e.* whether the insured must be fully compensated or whether a mere indemnity made by the insurer under the policy is enough. The judgement of *Napier v. Hunter* seemed to have made this point clear that only the full indemnity is enough. Despite this, another question still remains to be solved, *i.e.* how to distribute the proceeds recovered from the third party by the insurer rather than by the insured. Does the way of "recover down" adopted in *Napier* apply to the situation where the recovery from the third party is by the action of the insurer not by the insured ? This question is waiting for further legal solution. It is suggested that if, as the result of a subrogation action, the insurer recovered more than it had paid the insured, the latter would be entitled to the surplus in so far as it represented an uninsured loss.[120]

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[117] See *Castellain v. Preston* (1883) 11 Q.B.D. 380 at 388.
[118] (1929) 98 L.J.K.B. 308; (1929) 33 Ll.L.R.134.
[119] *Ibid.*, at 311, per Scrutton L.J.
[120] That is also the Australian approach in respect of the distribution of the recoveries. In the Australian ICA 1984, s. 67 is designed to ensure that the insured may participate in any subrogation recovery to the extent, and only to the extent, necessary to achieve a full indemnity for his loss. However, if there is any surplus, the insured has the right to get it. S. 67 will be discussed later. Professor Birds recommends introducing the Australian approach to the insurance law in UK, and suggested: "As far as the link between subrogation and excess clauses is concerned, Australia provides a model which seems to produce a fair result. S. 67 of the ICA 1984 of Australia in essence entitles the insured, where the insurer has successfully pursued a right of subrogation, to recover from the insurer enough money to ensure that he is fully indemnified for his loss. We believe a similar provision should be introduced in the UK to tackle cases of under-insurance and average clauses." See J. Birds, Insurance Law Reform, The consumer case for a review of insurance law, p.76, 1997.

(2) The insurer sues by using the insured's name

The second limb of subrogation allows an insurer who has made payment to the insured to step into the shoes of the insured to pursue, in the name of the insured, any remedy against a third party vested in the insured.[121] In so doing, the insurer is not conferred with a fresh and independent cause of action, the cause of action for damages remains with the insured and it is only in the insured's name that the insurer can pursue it. If the insured refuses to allow the insurer to use his name as a plaintiff, the insurer can by proceedings in equity compel him to give it[122]. Alternatively, the insurer may institute an action against the defendant in his own name, join the assured as a second defendant and ask the court to order him to lend his name to the action as a plaintiff or, perhaps, ask for an order that the first defendant pay damages to the second defendant and for a declaration that the second defendant holds such damages on behalf of the insurer.[123]

(3) The insurer's right to control proceedings

In England, as a general law, when the insurer has fully indemnified the insured, he can take over the control of proceedings on undertaking to indemnify the insured against his cost. However, an insured who has received a partial but not a full indemnity is free to commence proceedings against the third party for the full amount of his loss. In *Commercial Union Assurance Co. v. Lister*,[124] the insured's mill was damaged by an explosion for which, it was alleged, the local authority was liable. He was insured for £33,000 but the damage was estimated at £55,000. The insured wished to sue the authority, but the insurers sought a declaration that they were entitled to the benefit of any such action. It was held that as he would not be fully indemnified by his insurers, the insured was entitled to bring and control the action, provided he acted *bona fide* and sued for the whole loss. Even if the insurer has paid the insured in full under the policy, the insured can still, if he wishes, sue the third party and control the

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[121] *Mason v. Sainsbury* (1782) 3 Doug. K.B. 61.
[122] *Commercial Union Assurance Co. v. Lister* (1874) LR 9 Ch. 483
[123] See *King v. Victoria Insurance Co.* [1896] A.C. 250, 255-256; *John Edwards & Co. v. Motor Union Assurance Co.* [1922] 2 K.B. 249, 254; *Re Miller Gibb & Co.* [1957] 1 W.L.R. 703, 707.
[124] (1874) L.R. 9 Ch. 438.

proceedings if the insurer declines to do so. However, if the insured succeed, he must hold what he receives as chargee to repay the insurer what he has paid out under the policy.[125]

6.3 Subrogation or contribution – the rights of insurers

Having examined the insurer's right of subrogation against third party in English law, let us turn our attention to a very recent and interesting decision of English common law, *Bovis Construction Ltd and Eagle Star Insurance Co Ltd v. Commercial Union Assurance Co plc*,[126] in which the judge settled the dispute by applying the doctrine of contribution rather than subrogation. It is worthwhile giving a brief consideration to this new decision. The facts of this case is that Bovis, the contractor, and Rosehaugh, the owner of the building, entered into a management contract in September 1988, under which Bovis was appointed to manage the construction of an eleven storey office block in London. It was stipulated in the contract, *inter alia*, that once a certificate of practical completion of the building has been issued, there was a 12 month period during which Bovis was to be liable for defects. Bovis and Rosehaugh arranged insurance in a joint names policy with the Commercial Union (CU) covering their respective liabilities in respect of injury or damage to property arising out of the works and also the works themselves. They also effected their own policies separately. Rosehaugh had its own property policy issued by GA, and Bovis was insured against public liability by the Eagle Star (ES). One month later after the building was completed and the certificate of practical completion was issued by Bovis, it was discovered that a flood had occurred in the building's rooftop plant and boiler room due to the leak from the heating boilers. The water penetrated in to the building below, through an inadequately sealed cable hole in a floor slab and reached right down to the fourth of the eleven storeys. The loss was substantial, and the cost of remedial work was some £310,000.

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[125] *Morley v. Victoria Ins. Co.* [1936] 2.K.B. 359.

[126] This case has not been reported yet, and it is forthcoming in [2001] Lloyd's Rep I.R. However, this case was discussed by Professor Merkin, see *The Right of Insurers, Contribution*, [2001] Insurance Law Monthly, vol. 13, No. 2. pp.1-3.

Rosehaugh's insurer, the GA, has paid Rosehaugh and then sued Bovis who was held to caused the loss due the defects of the works, and succeeded. Bovis recovered its payment to Rosehaugh from ES (Bovis effected public liability policy with ES). ES then used Bovis's name to sue CU (Bovis and Rosehaugh jointly took out insurance in CU, including public liability) by subrogation to claim the payment to Bovis. The claim was refused on the ground that Bovis suffered no loss because ES had paid it. This rejection was supported by the court and it was held that ES could not exercise subrogation rights against CU in this situation. The principle was that an insurer who had indemnified the insured could not exercise subrogation rights against another insurer also liable for the same loss whether or not the two policies involved were identical in scope. Instead, he can seek a contribution from the another insurer by using his own name.[127]

It is submitted that ES took a wrong step to sue CU by exercising subrogation rights. This case, in fact, is double insurance, and the doctrine of contribution could be applied. A right of contribution exists whenever two or more insurers are liable for the same loss under concurrent policies and one insurer has made full payment of the loss. Under this circumstance, as Professor Davies comments, the paying insurer is not subrogated to the insured's right to an indemnity from the other insurer, that right having been extinguished when the insured was indemnified by the first insurer. Hence, it is a mistake for the paying insurer to proceed against the other insurer using the name of the insured.[128] Recently, some Scottish judges attempted to make a further development of the doctrine of contribution which has been applying in double insurance. In a recent Scottish case *Elf Enterprise (Caledonia) Ltd v. London Bridge Engineering Ltd.*,[129] it was held in the first instance that the principles of contribution are not confined to cases of double insurance. They apply whenever there are "co-ordinate" or overlapping obligations of indemnity, no matter what their source. In this case both the insurers and the contractors were liable for the insureds' loss. The insurers paid the insured in full and then claimed against the third party, the

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[127] That proposition was supported by the *Scottish Sickness & Accident Assurance Association v. General Accident Assurance Corporation Ltd.* (1892) 19 R. 977 and the English decision *Austin v. Zurich General Accident and Liability Insurance Co. Ltd.* [1945] 1 KB 250.

[128] See Martin Davies, *Subrogation, Contribution and Insurance Law: An Australian View,* [2000] Restitution Law Review, p. 70.

contractors, by exercising subrogation right by using the insureds' name. The contractors rejected the claim and argued that the pursuers (the insureds) had already been indemnified in full by the insurers in respect of their loss, so they had suffered no loss for which they could seek a contractual indemnity from the contractors. The contractors said that they and the insurers had both undertaken to indemnify the pursuers in respect of the same loss. What the insurers should have done was to proceed directly against them in their own name seeking a contribution. The contractors' argument was upheld by Lord Caplan in the first instance. However, on appeal, under the name *Caledonia North Sea Ltd v. London Bridge EngineeringLtd.*,[130] the lower court's decision was reversed. In giving judgement on appeal, Lord Sutherland was careful not to rule the possibility of an indemnity provision being an obligation that could be equated to insurance and when therefore there could be "double insurance" invoking the doctrine of contribution rather than subrogation. He concluded that contribution is a speciality of insurance law where the principle is that both policies are to be treated equitably as one. It is submitted that the contractors' argument and the first instance judgement are quite reasonable and logical. Indeed, both the insurers and contractors undertook to pay the pursuers for the same loss, why the insurers should be allowed to pass the whole of the indemnity obligation to the contractors. Professor Birds comments:[131] "In holding that the principle of contribution applied not just to insurers but also to anyone who provided an indemnity to another, the first insurance decision would therefore have been very significant in contexts where contractual indemnities are commonly provided and would have had a significant impact on insurers finding that their rights of recovery following their indemnification of an insured were significantly reduced."

As a matter of Australian law, the first instance decision in *Elf* would clearly be right. That "the principle of contribution is not confined to insurance law, but is a much broader principle arising whenever there are overlapping contractual obligations to indemnify" has long been used in common law in Australia. In the Australian case

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[129] [1997] TLR 607 (Ct Sn: OH).
[130] [2000] Lloyd's Rep. I.R. 249.
[131] See J. Birds, *Contribution or Subrogation: Orthodoxy Restored,* [2000] J. B. L., p. 348.

Albion Insurance v. Government Insurance Office of NSW,[132] Kitto J said that: "persons who are under co-ordinate liabilities to make good the one loss … must share the burden *pro rata*."[133] It is suggested that this rule should be developed in China. There are some questions may arise, such as whether a third party who is a tortfeasor (except someone who deliberately does something wrong), or under statute or in contract in circumstances which were indistinguishable from an obligation of indemnity can enjoy a contribution right instead of being sued by a subrogated insurer. This question is not intended to be discussed in this thesis owing to the limitation of the topics and space of the thesis.

6.4 Conclusion and suggestions

There are problems caused by the confusion of the two doctrines of subrogation and assignment in the Insurance Law 1995 and in practice in China, solutions of English law in this aspect are suggested to be used as a reference in solving these problems. Firstly, the insurer may sue by using the insured's name for the full loss, and secondly the insurer may control the proceedings and sue the third party upon payment under policy if the insured himself feels it difficult to do so. The recoveries shall be distributed first to make up the insured's portion representing the uninsured loss, and the surplus shall recoup the insurer. In this section, the differences between the principles of subrogation and contribution and the application of the two principles in Scotland, England and Australia have been also discussed. It has been held that what insurers may think of as "double insurance contribution" is not confined to insurance law, but is a much broader principle arising whenever there are overlapping contractual obligations to indemnify". It is suggested that this rule should be introduced to China.

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[132] (1969) 121 C.L.R. 342. See also the similar Australian case *Borg Warner (Aust) Ltd. v. Switzerland General Insurance Co Ltd.* (1989) 16 NSWLR 421.
[133] (1969) 121 C.L.R. at 350.

7. Persons Immune from Subrogation Proceedings

By the general rules of subrogation, the insurer is, in fact, exercising his subrogation right against a wrongdoer by standing in the insured's shoes and using the insured's name. So, in certain situations, the party with a subrogation right may be prevented from acting against the third party responsible for causing his loss by virtue of a contract between the insured and the third party or by operation of law. In China, the insurer usually use his own name to sue the third party; the Insurance Law restricts the exercising of the insurer's subrogation rights in certain situations is based on the reasoning of moral sense and the economic interdependence between the insured and the third party. Although in China, England, Australia, and other countries, the common law and statutory laws give different decisions and provisions in this respect, they share a common character in that the subrogation right should not be exercised against persons who are the members of the insured's family or those who have a special relationship with the insured. The approaches adopted by the different countries' laws are slightly different, and so they are now considered separately in turn.

7.1 The Chinese approach

In China, only article 46 of the Insurance Law gives a stipulation as to which persons the insurer cannot exercise subrogation rights against. Article 46 states: "The insurer may not exercise his right to claim indemnity by subrogation against the insured's family members or other persons comprising such family of the insured, unless the insured's family members or other persons comprising such family of the insured cause an event insured against to occur intentionally as mentioned in para.1 of article 44 hereof." The purpose of this article is to inhibit an insurer from exercising its subrogation right against the members of the insured's family or other persons comprising such family of the insured, where such members or persons cause the insured event carelessly or negligently rather than wilfully. The intention of this provision is to protect the interest of the insured and his family and other persons comprising such family of the insured. However, there are no definitions on the two phrases of "family members" (*jia ting cheng yuan*) and "other persons comprising such family of the insured" (*bei bao xian ren de zu cheng ren yuan*). This ambiguity

causes different interpretations or understandings of the two phrases. It is interpreted by Yu Xinnian, a deputy general editor of the Press of the Supreme People's Court: "Family members refers to husband and wife, their parents, and children," and "Other persons comprising such family of the insured refers to other persons except the members mentioned above, such as grandparents, grandparents in law, grandchildren, grandchildren in law, brothers, sisters and persons who are supporters of the insured or persons who are supported by the insured."[134] One writer has a different interpretation for these two phrases. He tried to give a definition of the two phrases:[135] "By the broad meaning, the family members of the insured (*bei bao xian ren de jia ting cheng yuan*) refers to persons who live with the insured, such as spouses or relatives with a blood relationship or marital relationship, or persons who do not live with the insured, but are financially interdependent." "*Bei bao xian ren de zu cheng ren yuan* refers to persons who act for the insured or as the insured's trustee or have a special relationship with the insured, such as the insured's employees or business partners or his agents." These two interpretations are absolutely different.[136] In another version of English translation for the Insurance Law, the second phrase of *bei bao xian ren de zu cheng ren yuan* was translated as "staff member of the_insured".[137] In the lack of further complementing rules or judicial explanations of these phrases, it is suggested that the first interpretation is correct and reflects the law-maker's real intention.

This provision is an important and necessary step to protect the interest of the insured and his family or other persons comprising such family, especially in China, where the social system and traditional culture are different from those of the western countries. In China, husband and wife have a duty to maintain each other,[138] parents have a duty to bring up and educate their children and children have a duty to support and assist

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[134] See Yu Xinnian and Gao Shengping, Zuixin Baoxianfa tiaowen Shiyi (The Most Recent Interpretation on the Articles of the Insurance Law), P. 118, People's Court Press, 1995.
[135] Han Yanchun, "*Dui Baoxian Daiweiqiushangquan Xingshi De Xianzhi De Guiding" (The restriction for the exercise of insurance subrogation right)*, Baoxianfa Shiyin Chuanshu (The handbook for insurance law), p.346, China Procuratorial Press. 1996.
[136] Due to the ambiguity of these two phrases in Chinese Insurance Law, the different translation organisation made different translation in English for these two phrases. For example, by the Chubb China Operations, the phrase *bei bao xian ren de zu cheng ren yuan* was translated as "staff members", while it was translated into "other persons comparising such family of the insured" by Beijing University.
[137] See the English translation for the Insurance Law of the PRC, China Legal Publishing House, 2000.
[138] See art. 14 of the Marriage Law 1980 and art. 20 of the amended Marriage Law 2001.

their parents;[139] they are economically interdependent. In this situation, to allow an insurer to exercise his subrogation right against a member of the insured's family would constitute a case of giving with the one hand and taking with the other. For instance, a person insured his house against fire, and his mother who lived with him and was financially dependent on him caused a fire negligently when she was cooking, and damaged the house. If after paying the insured, the insurer exercises his subrogation right to claim against the insured's mother, it is, in fact, an action against the insured in a financial sense, because he was her financial supporter and he has to satisfy the claim himself. It is obviously unfair to permit an insurer to exercise his subrogation right where the insured paid the premium but finally has to bear the loss himself. It is also not reasonable in a moral sense to allow an insurer to sue the insured's mother by way of subrogation even if the insurer uses his own name. The same reasoning applies to the other family relationships stipulated in article 46 of the Insurance Law.[140]

However, if the insured event is caused by wilful misconduct of the insured's family members or other related persons, they cannot escape a subrogation claim by the insurer. This is fair to the insurer and not unfair to the wilful wrongdoer, because any insured who deliberately causes an insured event to occur may be refused the right of recovery from the insurer, so the wilful wrongdoer cannot enjoy immunity from the insurer's subrogation right.

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[139] Art. 15 of the Marriage Law 1980 and art. 21 of the amended Marriage Law 2001.

[140] It is submitted that in China, the restriction of the insurer's subrogation right is not based on the procedural rule that the plaintiff can not sue his own family member. Rather it is based on the financial relationship and moral sense, because in China it is not necessary that the insurer sues a third party by using the insured's name, usually the insurer acts in his own name. However in England, as a subrogated insurer has to take action by using the insured's name, he is therefore only entitled to the benefit of any right of action that the insured himself possesses. It follows that any defence that the third party could raise in an action brought against him by the insured personally should also be an effective defence to a subrogation action. Thus the insurer has no right to sue his own insured by way of subrogation simply because the insured has no right of action to sue himself for the damage. See *Simpson v. Thomson* (1877) 3 App. Cas. 279. Also the insurer was not entitled to exercise his subrogation right against the insured's wife because the insured himself had no right of action to sue his own wife until the English Law Reform (Husband and Wife) Act 1962 by which interspousal immunity was abolished. See *Midland Insurance Co. v. Smith and Wife* (1881) 6 Q.B.D. 561.

Unfortunately, the Insurance Law ignores the industrial relationship restriction for the insurer's subrogation right,[141] for example, where the third party is an employee of the insured employer or a partner of the insured or a co-insured, etc. It is not clear whether it is a negligent lacuna or it is the law-maker's intention. It is not important to discuss which reason it is, but the lacuna is an unfortunate thing. If the insurer's right of subrogation is allowed in this situation, good industrial relationships between the insured and his employee or his partners would be prejudiced. So it is suggested that this lacuna in the Insurance Law should be filled. Since 1980, when the economic reform started, lots of private partnership businesses have emerged, and they usually insure their property jointly under a single policy, that is the case of co-insurance. If the insurer is entitled to sue a negligent partner after paying the victim partner, not only would their partnership be harmed, but also their business would be affected. It is really an awkward situation for the insurer to pay one of his insured and claim against another of his insured or claim against the insured's employee. However, in practice, the insurer is not allowed to exercise his subrogation right against a co-insured. There is an extra Third Party Liability insurance attached to the Contractor All Risks Policy, the main content of this extra insurance is that "..... for the loss caused by a co-insured due to his fault or negligence, after the payment by the insurer to the insured who suffered the loss, the co-insured who caused the loss is immune from the insurer's subrogation action."[142] It could be suggested that this good practice should be adopted in the Insurance Law.

7.2 The English solution

(1) The insured himself

It is quite easily to understand why English common law has decided that the insurer has no right of subrogation to sue his own insured who causes the insured loss for himself, because the insured has no right of action to sue himself, so the insurer can be

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[141] However, if the phrase of *bei bao xian ren de zu cheng ren yuan* in art. 46 is understood as "persons who act for the insured or as the insured's trustee or have a special relationship with the insured, such as the insured's employees or business partners or his agents," or "staff of the insured", the industrial relationship should be included in art. 46.

[142] See the Contractor's All Risk policy and the Extra Third Party Liability Insurance of the PICC.

in no better position. The leading case which illustrates this point is the decision of *Simpson v. Thomson.*[143] The insured had two ships which collided due to the negligence of one of the masters. In respect of the ship which was negligently sailed, the insured paid money into court, as he was statutorily bound to do, in order to compensate the various parties involved. The insurers paid for the other ship and then claimed the right to use the insured's name as owner of this ship to claim against the fund. It was held that the insurers had no such right, as it would be tantamount to the insured suing himself, which, of course, is impossible. This case did not decide whether it would be the same result if the two ships had been owned by different companies. Some authoritative writers submit that it is unlikely that the same result would be reached if the ships were owned by two companies, albeit they were both owned or controlled by the same person.[144]

(2) Family relationship

In England, as the present law stands, an insurer is not prevented from exercising his subrogation right against the insured's spouse or his family members simply because, in general, there is no legal restriction on the members of a family to sue each other in tortious action. However, it used to be the situation that the common law prohibited the insurer from exercising subrogation rights against an insured's wife simply because the husband could not sue his own wife then. In common law the spouses were considered to be one person, and the rule developed that a tortious action could not be brought by one against the other.[145] The operation of this principle in the context of subrogation is illustrated by *The Midland Insurance Co. v. Smith and Wife*[146]. The wife of the insured had deliberately set fire to the insured's property, and as a result it was destroyed. An action was brought by way of demurrer to test the insurer's contention that, if it was liable to indemnify the insured under the policy, then similarly it was entitled to sue him and his wife for damages for the loss caused to it by the

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[143] (1877) 3 App. Cas. At 279.
[144] See Robert Merkin, Colinvaux's Law of Insurance, 7th ed., p.180; See also J. Birds, Modern Insurance Law, 4th ed., p. 300; See also Lord Blackburn's statement in *Simpson v. Thomson* (1877) 3 App. Cas. 294.
[145] *Phillips v. Barnet* (1876) 1 Q.B.D. 436.
[146] *Midland Insurance v. Smith* (1881) 6 Q.B.D. 561.

wife's action.[147] This argument was rejected by the court, which held that there was no right of subrogation where the only right of the insured was against his wife. However interspousal immunity was abolished in England in 1962 by the Law Reform (Husband and Wife) Act.

Whether the abolition is correct or not, there is no authority and no commentators comment on it, but it is submitted that the right of subrogation against the members of the insured's family should be restricted. Immunity from subrogation for such persons is good reasoning both in respect of the legal procedure and because of the financial relationship between the insured and such persons with blood relationships. So the British National Consumer Council suggests restricting the insurer's subrogation rights where the subrogation rights are against members of the insured's family.[148] However, in my opinion, if such a person deliberately causes an insured loss, that person should not be immune from the insurer's subrogation against him.

(3) Co-insurance

This is a more complicated situation in respect of exercising the subrogation rights in the case of co-insurance. The nature of co-insurance is that, under one policy, two (or more) persons insure property in which each (or all) of them has an interest. Lots of examples can be given for co-insurance situations, such as mortgagor and mortgagee, landlord and tenant, bailor and bailee and business partnership, etc. The question here is that if the property is damaged by the fault of one of the co-insureds, and the insurer indemnifies the other against his loss, is the insurer then entitled to exercise a right of

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[147] This was an illustration of the old common law rule that a woman's husband had to be joined as a co-defendant in any tortious action against her. If the plaintiff obtained judgement against them, generally he could only execute against the husband's property. It is true that, in common law, the personal chattels and money of a woman were vested absolutely in her husband upon their marriage, and the husband acquired a freehold interest during the joint lives of himself and his wife in any real property of which she was seized when they were married. See *Halsbury's Laws of England* (4th ed., 1979), vol. 22, pp. 628-629. The effects of this rule were abolished in England in 1882 by the *Married Women's Property Act,* which allowed a married woman to hold property on her own and to sue and be sued as if she were a single woman. The equivalent Victorian provision is now contained in the *Marriage Act* 1958, s. 156. In addition, a husband in common law was vicariously liable for the torts of his wife. This rule was not abolished in England until 1935 by the *Law Reform (Married Women and Tortfeasors)* Act 1935, s.3. In Victoria, see the *Marriage Act 1958,* s. 159.

[148] See Birds, the Report of Insurance Law Reform, the Consumer Case for a Review of Insurance Law, p. 76, 1997.

subrogation, suing the person at fault in the name of his co-insured? In England, a view put forward in MacGillivray is that, in theory, the rights of subrogation do exist between co-insureds but will usually in practice be defeated by circuity of action.[149] The question was first addressed by Lloyd J in *The Yasin.*[150] In this case both the plaintiff and the defendant took out insurance for the plaintiff's cargoes loaded on the vessel.[151] The vessel became a total loss, and the plaintiff was paid under the policy. One of the issues was if the plaintiff was entitled to make any claim against the defendant for the account of subrogated underwriters. The learned judge rejected the argument that there was any general principle which prevented an insurer from exercising subrogation rights against a co-insured. He held that any subrogation immunity rested on the principle of circuity.[152] He also held that the rule of subrogation immunity applies only under the situation where A is insured against damage to goods, and B is insured against his liability for damage to the goods under the same policy. If the damage of A's property is caused by B's negligence, after he has indemnified A, the insurer plainly cannot exercise subrogation rights in A's name against B, because B himself is entitled to claim under the policy which covers his liability for A's property. Thus the subrogation action would give rise to circuity in claims, If A and B were both insured against damage to property, and B negligently damaged A's property, B would not be immune from a subrogation action merely because he was a co-insured under the policy, as his interest under the policy was not the same as that of A.[153] However, in his later judgement in *Petrofina Ltd v. Magnaload Ltd*,[154] the learned judge somewhat modified the view he had in *The Yasin.*

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[149] See MacGillivray on Insurance Law, (9th ed.), p. 570, para. 22-98, 1997.

[150] *The Yasin* [1979] 2 Lloyd's Rep. 45.

[151] In this case, the charterparty provided that if any vessel chartered was more than 15 years old (the vessel in question was), the owner of the vessel were to procure insurance from Lloyd's in respect of the cargo.

[152] Lloyd J's explanation for the circuity was summed up by Professor R. Merkin in his Insurance Contract Law (Loose-leaf), p. C.4.3-54.

[153] Lloyd J stated: "It is said to be a fundamental rule in the case of joint insurance, that the insurer cannot exercise a right of subrogation against one of the co-insureds in the name of the other. I am not satisfied that there is any such fundamental rule. In my judgement, the reason why an insurer cannot normally exercise a right of subrogation against a co-insured rests not on any fundamental principle relating to insurance, but on ordinary rules about circuity. In the present case, a claim in the name of the plaintiffs might well have been defeated by circuity if the insurance had purported to protect the defendants against third party liability. But that was not argued by Mr. Philips (Counsel for the defendants). As I have already mentioned, his submission was that the insurance protected the defendants' proprietary interest as bailees. That being so, I do not see how circuity can help the defendants in this case." [1979] 2 Lloyd's Rep. 45 at 54-55.

[154] [1984] 1 Q.B. 127.

He insisted in the latter case that the principle of circuity applies to both types of policy described above. So the insurer was not allowed to exercise his subrogation right in the latter case. The fact in *Petrofina* is that the main contractors for the construction of an extension at an oil refinery took out a contractors all risks insurance policy with the insurer who agreed under the policy to indemnify the insured against loss and damage to the property. The insured were defined as the main contractors, the sub-contractors, the fourth plaintiffs, who held a lease of the refinery, and the third plaintiffs, a company holding the freehold and managing the refinery on behalf of the first and second plaintiffs. The main contractors employed sub-contractors for the heavy lifting operations involved in the work and they in turn agreed with the two defendants that the defendants should supply specialist heavy lifting equipment and services. The second defendant, a Dutch company, was to be responsible for the operation but the contract was made with the first defendant, its associated English company. During the dismantling of the equipment provided by the defendants, the gantry became displaced and fell to the ground causing much damage to the work in progress. The third plaintiff made a claim against the insurers under the policy, which was duly settled. The insurers thereupon brought an action in the name of the plaintiffs against the defendant, claiming damages for negligence. By their defence the defendants denied that the insurers were entitled to exercise any right of subrogation against the defendants, since the defendants were fully insured under the same policy in respect of the same property. It was held that the insurers had no right of subrogation against the defendants in the name of the plaintiffs, who were co-insured with the defendants under the same policy. A similar view was taken in the subsequent decision in *National Oilwell (U.K.) Ltd v. Davy Offshore Ltd.*[155]

However, if a co-insured has been guilty of wilful misconduct which disqualifies him from claim under the policy, English law does not protect him from the insurer's exercising of subrogation rights against him. The insurer is entitled to exercise subrogation rights against him so that, having paid the innocent party, the insurer can recover its payment from the guilty party.[156]

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[155] [1993] 2 Lloyd's Rep. 582.

[156] See *National Oilwell v. Davy Offshore*, in which Colman J took the view that, if wilful misconduct were proven, the subcontractor would lose subrogation immunity.

(4) Where the wrongdoer is the insured employer's employee

In England, the authorities in relation to this question are *Lister v. Romford Ice and Cold Storage Ltd.* [157] and *Morris v. Ford Motor Co.*[158] The facts are similar between these two cases, but the decisions of them were definitely contrary. In *Lister* the appellant, an employee of the respondent negligently injured another employee while reversing a lorry. The respondent employer was therefore vicariously liable to pay damages to the injured employee, an award satisfied by the respondent's liability insurers, who then used the respondent's name to sue the negligent employee to recoup his payment. It was held that the employee was liable to his employer for loss suffered as the result of the employee's negligence in the performance of his work. So the insurer's subrogated claim succeeded. However the dissenting view put forward by minority judges (Lord Radcliffe and Lord Somervell of Harrow) is considered much more realistic and acceptable.[159] They implied a term into this particular contract of employment to the effect that the employer would ensure that the employee was protected by insurance from any liability arising from the use of the lorry.

The decision of *Lister* evoked big repercussions and a contrary view was produced that if an insurer were allowed in the employer's name to sue the employer's servants in such circumstances, good industrial relations would be harmed. So in England an Interdepartmental Committee was appointed by the Minister for Labour and National Service to study the effect of *Lister* on industrial relations. It discovered that, after the House of Lords' decision, a "gentleman's agreement" had been made between certain employers' liability insurers (members of the British Insurance Association (now the ABI) and underwriters at Lloyd's who specialise in liability insurance) and the British Employers' Confederation. Under this agreement, "the employers' liability insurers agree that they will not institute a claim against the employee of an insured employer in respect of the death of or injury to a fellow-employee unless the weight of evidence clearly indicates (i) collusion, or (ii) wilful misconduct on the part of the employee

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[157] [1957] A.C. 555.
[158] [1973] Q.B. 793.

against whom a claim is made."[160] It is clear that by the "gentleman's agreement" the insurers agreed that, apart from certain exceptional cases (such as collusion or fraud), subrogation rights would not be exercised without the employer's consent. It has had understandable influence in later English decisions.

The judgement of *Morris v. Ford Motor Co.*[161] was clearly influenced by the "gentleman's agreement". The facts of *Morris* were similar to that of *Lister*, but the decision is different from that made in *Lister*. In *Morris*, Cameron Industrial Services Ltd (Cameron) contracted with Ford Motor Company to clean at Ford's works. In their contract, a term provided that Cameron would indemnify Ford in respect of any liability for the negligence of their respective employees. The plaintiff was employed as a cleaner by Cameron at Ford's factory and was injured by an employee of Ford for whom Ford had vicarious liability. Ford claimed an indemnity from Cameron under the term provided in the contract and it was settled. Cameron brought an action against Ford's negligent employee on general principles of subrogation. Judgement was given for Cameron in the first instance and the Ford's employee appealed and it was allowed. On the appeal, Lord Denning M.R. stated that it was not just and equitable that Ford should be compelled to lend its name to Cameron to be used to sue its servant or alternatively, there was no implied term that Cameron should be entitled to use Ford's name to do so.[162]

Although Cameron was not an insurer as such, though no doubt it was backed by one, its position was analogous to that of an insurer and in particular to the position of the insurer in *Lister*. It is submitted that the decision of *Morris* is welcomed and satisfactory. There is no doubt that the decision of *Morris* has effectively stymied the application of subrogation in the employer's liability field as a matter of practice in England. The decision of *Morris* was obviously influenced by the "gentleman's agreement". Unfortunately, the "gentlemen's agreement" lacks legal force. So the

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[159] Some writers seem to prefer the minority judges' view, see J. Birds, Modern Insurance Law, 4th ed., p.295 1997; see also Derham, Subrogation in Insurance Law, p. 42, 1985.
[160] See Gerald Gardiner's note on the 1957 Committee Report in (1959) 22 M.L.R. 652. See also A A Tarr, *The Insurance Contracts Act Revisited,* [1991] I.L.J., pp.216-249, at 240.
[161] [1973] Q.B. 793.
[162] [1973] Q.B. 793, at 801-802.

British National Consumer Council recommends law reform to restrict the insurer's subrogation rights against an employee by the employer's insurer.[163]

7.3 Alternatives in other countries (Australia, America and Canada)

(1) The Australian approach

In Australia, sections 65 and 66 of the ICA 1984 specify situations where the insurer's subrogation rights are restricted.

(a) Subrogation to rights against family

Section 65 of the ICA 1984 provides that an insurer under a contract of general insurance is not entitled to be subrogated to the rights of its insured against an uninsured third party when the insured himself has not exercised, and might reasonably be expected not to exercise, those rights by reason of:

(i) a family or other personal relationship between the insured and the third party;

(ii) the insured having expressly or impliedly consented to the use, by the third party, of a road motor vehicle that is the subject-matter of the contract. [164]

As a comment put by Derham in his exhaustive monograph,[165] this restriction on the exercise of subrogation rights against members of the insured's family is a commendable reform. Due to the fact that a large number of families are economically interdependent, and allowing a right of subrogation against a member of the insured's family, to some degree, amounts to a claim against the insured himself. Quite often the person suffering the loss would not have sued even if he had not been insured. However there is no definition of "family or other personal relationship" for the purpose of subsection (1)(c)(i), though the Australian Law Reform Commission in its Report on Insurance Contracts indicated that it should include close relatives or friends

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[163] See Birds, Insurance Law Reform, the Consumer Case for a Review of Insurance Law, p.76, published by British National Council, 1997.
[164] See Australian ICA 1984, s. 65[c] (i).
[165] S.R. Derham, Subrogation in Insurance Law, p. 44, The Law Book Company Limited, 1985.

of the insured.[166] If this indication is correct, it is submitted that it is not very reasonable and not really fair to the insurer by making provision in section 65(1)(c)(i) to restrict the insurer to exercise subrogation rights against a third party who has a personal relationship with the insured, for example, the insured's friend, where the insured has not exercised, and might reasonably be expected not to exercise, his right. However this immunity of the insurer's rights of subrogation does not operate where the conduct of such a third party that gave rise to the loss was serious or wilful misconduct.[167]

(b) Subrogation right cannot be exercised against the employer's employee

Section 66 of the ICA 1984 (Australia) provides that,: "where the rights of an insured under a contract of general insurance in respect of a loss are exercisable against a person who is his employee, the insurer does not have the right to be subrogated to the rights of the insured against that employee if the conduct of the employee that gave rise to the loss occurred in the course of or arose out of the employment."[168] However, this is made subject to the proviso that the conduct should not have constituted serious or wilful misconduct. Although this section causes disputes on the point of what conduct and what extent may be defined as a serious or wilful misconduct,[169] and it seems that for the serious or wilful misconduct a test should be necessary to be standardised by law or by some other regulations. This provision is really great progress in view of protection of the industrial relationship between the employer and employee. For industrial and sometimes personal reasons and because of the vulnerability of an employee, most employers are usually reluctant to seek recovery for their losses particularly if they are insured. If an insurer is allowed to sue the employee by using the employer's name after he has paid the employer,[170] it amounts to the same as the employer himself suing his employee, then the relationship between the employer and the employee will be harmed. Section 66 is regarded as a provision to

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[166] See the *A.L.R.C. Report on Insurance Contracts* (Report No. 20, 1982), pp.187-188.
[167] S.65 (2)(b) of the ICA 1984.
[168] This provision is quite similar to the English "gentleman's agreement". While the "gentleman's agreement" has no legal force, s.66 puts the "gentleman's agreement" into statutory form, omitting the reference to "collusion". See Ray Hodgin, Insurance Law Text and Materials, p.565.
[169] The Hon Mr Justice Derrington, *Subrogated Recovery against an Employee* [1990] I.L.J., vol.3, No.1, p.5.

ensure that a fair balance is struck between the interests of insurers, insureds and other members of the public.

(2) The Canadian and American approaches to subrogation in co-insurance cases

S.R. Derham in his monograph summarised three theories dealing with the exercise of subrogation in a co-insurance case. They are:[171]

(a) the view put forward in MacGillivray, that subrogation is always allowed against a co-insured, but that in practice circuity of action will mean that the right is seldom exercised;[172]

(b) the approach adopted in Canada, to the effect that subrogation between co-insureds is only prohibited if the co-insureds can be regarded as one person; and

(c) the "equitable" approach adopted in America, according to which it is said to be inequitable to allow an insurer to exercise a right of subrogation against one of its insured.

The first theory, *i.e.* the English view put forward in MacGillivray, was discussed earlier. Now it is worth considering the Canadian and American views on this point. The Canadian courts have applied a different test to determine whether rights of subrogation are exercised by an insurer in the co-insurance situation. The leading case is *Commonwealth Construction Co. Ltd v. Imperial Oil Ltd and Wellman-Lord (Alberta) Ltd.*[173] In this case, Imperial Oil had contracted with Wellman-Lord for the construction by the latter of a fertiliser plant. The Commonwealth Construction Company was a subcontractor working on a part of the site. A fire caused by the negligence of the employees of Commonwealth damaged not only the part of the site on which Commonwealth was working, but also a substantial portion of the remainder of the project. Imperial Oil had taken out a multi-peril subscription policy which, *inter alia,* provided for an indemnity against damage by fire to the property. The policy identified the insured as Imperial Oil, and any of its contractors and subcontractors.

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[170] This is the decision of *Lister v. Romford Ice & Cold Storage Co Ltd.* [1957] A.C. 555.
[171] S.R. Derham, Subrogation in Insurance Law, p. 75, The law book company limited, 1985.
[172] See MacGillivray and Parkngton on Insurance Law (7th ed.) 1981, p.509, para.1214 which was cited by Derham in his book; See also MacGillivray on Insurance Law, (9th ed.) 1997, p.570, para. 22-98.
[173] (1976) 69 D.L.R. (3d) 558.

The insurer indemnified Imperial Oil for the loss, and then brought a subrogation action against Commonwealth, arguing that Commonwealth only had an insurable interest in the property to the extent of its liability for damage to the part of the site on which it was working, and that therefore it should be liable for the amount paid with respect to the damage to the remainder of the site. However, in view of the ever-present danger of a subcontractor damaging parts of a project other than those under its immediate control, it was held that Commonwealth, as well as Imperial Oil, had an insurable interest in the whole project, and that the insurance covered each to the full extent of this interest. The court regarded the contractor and subcontractor as the one person, so it was held that no right of subrogation could be exercised against the subcontractor. By this case it is noted that the Canadian Supreme Court adopted the approach in respect to co-insurance that in the case of true joint insurance "the interests of the joint insureds are so inseparably connected that the several insureds are to be considered as one with the obvious result that subrogation is impossible".[174] In the event of the co-insureds having different interests *e.g.* bailor and bailee, landlord and tenant etc., the existence of a right of subrogation was said to depend on the extent of these interests. "If the different interests are pervasive and if each relates to the entire property, albeit from different angles, again there is no question that the several insureds must be regarded as one and that no subrogation is possible."[175] It is only if the extent of the insurable interest of each co-insured is different that an insurer has a right of subrogation against a co-insured, because in such a case it is not possible to regard them as the one person.

American courts generally have denied an insurer a right of subrogation against a co-insured, the reasoning being that it is not equitable to allow an insurer to exercise subrogation right against a co-insured for whose benefit the insurance was taken out. They based this on the premise that subrogation is an equitable right, the theory being that the insurer seeking equity must do equity, and that an insurer who sues its own assured is acting inequitably, and against public policy. The rationale for this rule was explained by the Supreme Court of Montana in *The Home Insurance Co. v. Pinski Bros*

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[174] *Ibid.* at 561.
[175] *Ibid.*

Inc.[176] In this case, the Home Insurance Company, who paid off a property damage loss resulting from a boiler explosion at a hospital, claimed subrogation to the rights of the hospital (its policyholder) against the mechanical contractor and the architects. The architect took out a comprehensive liability insurance with the Home Indemnity Company, a wholly owned subsidiary of the Home Insurance Company. The architect made defence on the ground that the coverage of the comprehensive liability policy constituted a defence against the claim of the parent company, the Home Insurance Company, so there should not be any subrogation against him. It was held by the court that "To permit the insurer to sue its own insured for a liability covered by the insurance policy would violate these basic equity principles, as well as violate sound public policy. Such action, if permitted, would (1) allow the insurer to expend premiums collected from its insured to secure a judgement against the same insured on a risk insured against; ... (4) allow the insurer to take advantage of its conduct and conflict of interest with its insured; (5) constitute judicial approval of a breach of the insurer's relationship with its own insured. No right of subrogation can arise in favour of an insurer against its own insured since, by definition, subrogation exists only with respect to rights of the insurer against third persons to whom the insurer owes no duty."[177]

Not only have American courts adopted this approach when the liability of the co-insured is covered by the contract of insurance but also in situations where the co-insured does not have an insurable interest in the subject of the policy. In other words, as long as a person is nominated as an insured, the rule that a right of subrogation may not be exercised against a co-insured may be invoked. In *Great American Insurance Co. v. Curl,* [178] a homeowner's insurance policy covering damage to buildings was taken out by the named insured. The 'insured' was defined in the policy as including (1) the named insured, and (2) if resident in his household, his spouse, and the relatives of either. The mother-in-law of the named insured, who resided with him, ran her car into the wall of his garage. The named insured was indemnified by the insurer for the damage, and a subrogation action was commenced against the mother-in-law. The

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[176] (1972) 500 p. 2d 945.
[177] *Ibid*, at 949.
[178] (1961) 181 N.E. 2d 916.

insurer acknowledged that a right of subrogation cannot be exercised against a co-insured, but contended that the fact that she did not have an insurable interest in the property of the named insured meant that in this particular case she could not be an insured under the policy. However the Court of Appeals of Ohio held that it was not necessary that she should have an insurable interest, because none of the evils which the rule requiring an insurable interest was designed to guard against were present. She had no interest, and she stood to gain nothing from the loss suffered by her son-in-law. Therefore it was held that her lack of an insurable interest did not disentitle her from being an insured for the purposes of the rule preventing the exercise of subrogation rights against a co-insured.

7.4 Conclusion and suggestions

In this context there are some disputes about which persons may enjoy immunity from the insurer's subrogation claim. In England, as the present law stands, the insurer is not limited in suing the insured's family members by way of subrogation, although the restriction was put on the spousal relationship by common law[179] before 1962 when interspousal immunity was abolished by the *Law Reform (Husband and Wife) Act*.1962. In Australia, the statutory law expressly stipulates that an insurer is not entitled to be subrogated to the rights of the insured against an uninsured third party when the insured himself has not exercised or might reasonably be expected not to exercise those rights by reason of a family or other personal relationship between the insured and the third party.[180] This approach is worthy of praise. Moreover, the Australian ICA 1984, section 66 makes it clear that where the rights of an insured under a contract of general insurance in respect of a loss are exercisable against a person who is his employee, the insurer does not have the right to be subrogated to the rights of the insured against that employee if the conduct of the employee that gave rise to the loss occurred in the course of or arose out of the employment. As far as co-insurance is concerned, where two (or more) persons insure property in which each of

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[179] *Midland Insurance Co. v. Smith and Wife* (1881) 6 Q.B.D. 561. It is submitted that in this case the view that the insurer cannot sue the wife by using the husband's name is acceptable and is fair, but the judgement for the defendant even under the wife's malicious intention and wilful conduct is not fair for the insurer.

[180] Australian ICA 1984, s.65.

them has an interest, if the property is damaged by fault of one of them, and the insurer indemnifies the other against his loss, whether the insurer is entitled to exercise a right of subrogation, is a more difficult question, and there are several arguments about this. The English approach was illustrated in *The Yasin* and *Petrofina,* which was analysed in MacGillivray and basically held that the rights of subrogation in theory exist between co-insureds but will usually in practice be defeated by circuity of action.[181] The Canadian approach is reflected in *Commonwealth v. Imperial Oil,* which held that where the co-insured have an identical interest or their different interests are pervasive and if each relates to the entire property, albeit from different angles, there is no right of subrogation for the insurer. The American approach is also to disagree with the insurer having right of subrogation in a co-insureds context. Its reasoning is that an insurer's action against its own insured is inequitable and against public policy. Although these three approaches are based upon different reasoning, they have the same target, which is, the insurer should not exercise his subrogation right to his own insured under the co-insureds circumstances where one co-insured causes losses for another.

In China, article 46 of the Insurance Law restricts an insurer's subrogation right on the family members of the insured, but there is no provision in respect of the insurer's subrogation right on an insured's employee or co-insured. It is suggested that Australian and English models about the restriction on the insurer's subrogation right

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[181] MacGillivray on Insurance Law, (9th ed.), p.570, para.22-98, 1997. See also Patrick Mead, *Of Subrogation, Circuity and Co-insurance: Recent Developments in Contract Works and Contractor's All Risk Policies* [1998] I.L.J., vol. 9, No.2, pp.125-157. He analysed English cases relating to co-insurance, and summarised : "On the present state of the English authorities, the following principles may be derived: (1) A contractor/subcontractor/supplier of equipment (even, it seems, one who takes no part in the construction at a project site) is able to insure against loss of or damage to property involved in the common project not owned by it and not in its possession. (2) In the case of a contractor's all risk policy, the contractor may, in the absence of words of severance in the policy (as in *Petrofina*), recover the whole of the loss insured, and not just the loss suffered by it in respect of the property which it owns or for which it is responsible, holding the excess over its own interest in trust for the others. (3) Whether the contractor is an assured is a question of construction of the policy of insurance. The negligent co-assured must show that the innocent co-assured clearly intended to insure on its behalf. For the purposes of ascertaining whether it was intended to make such person an assured, not only the policy documents but also the construction contract and associated documents may be looked at. (4) If, on the proper construction of the policy, the contractor is an assured, there will be no right of subrogation on the part of the insurers as this would be in breach of an implied term of the insurance contract and therefore lead to circuity of action. (5) If, on the other hand, on the proper construction of the policy, the contractor was not intended to have the benefit of the insurance, it will not be a co-assured and the insurer may exercise its rights of subrogation.

against an employer's employee and the American approach which restricts an insurer's subrogation right against a negligent co-insured on an equitable reasoning can be followed in China.

8. Insured's Duties under Subrogation

Both Chinese insurance law and English insurance law require the insured not to do anything to prejudice the insurer's right. The purpose of the rule is to protect the insurer's right of subrogation. However, there are some differences between English law and Chinese law in respect of the application of this rule. In England, a compromise entered into between the insured and the third party is normally binding on the insurer, no matter whether it is made before or after indemnification by the insurer. This is because the insurer exercises his subrogation right by using the name of the insured, who is the nominal plaintiff. The insurer cannot have any better rights than those possessed by the assured. So once the insured renounces his rights, the insurer's subrogation right must be lost. While in China, as was discussed earlier, the insurer usually exercises his subrogation right in his own name, once the insured has been paid by the insurer, the former's right is assigned to the latter, so any settlement or compromising agreement between the insured and the third party will not bind the insurer after the insurer's indemnity

8.1 The insured's duty in China

In China, article 45 of the Insurance Law provides: "where the insured waives his right to claim indemnity from a third party following the occurrence of an event insured against and prior to the insurer's payment of insurance monies, the insurer shall not be liable for the payment of insurance monies." And "where the insured, without the consent of the insurer, waives his right to claim indemnity from a third party after the insurer has paid insurance monies to him, the waiver shall be void." And "where the insurer is unable to exercise his right to claim indemnity by subrogation due to the fault of the insured, the insurer may make a corresponding deduction from the amount of indemnity."

This article clearly provides stipulations to protect the insurer's rights of subrogation. If the insured does anything which prejudices the insurer's rights of subrogation before the indemnity by the insurer under the policy, the insurer's remedy will be the repudiation of any liability of the policy. Before the payment by the insurer to the insured, the control of proceedings remains with the insured, and the insurer has no right to sue the third party,[182] so any settlement or compromise agreement between the insured and the third party binds the insurer. If the insured renounces the right, the insurer will lose his subrogation right; the insurer is therefore able to avoid liability. A Chinese case illustrates this point.[183] A truck named "East Wind" owned by Mr Zheng collided with a "Yellow River" truck due to the carelessness of the driver of the "Yellow River". The insured owner of the "East Wind" made a claim against the owner of the "Yellow River", and agreed to accept a sum of RMB 7,000 for a full settlement which he thought should be enough for the repair cost. The actual repair cost turned out to be RMB 8,800. The insured then turned to his insurer for RMB 1,800. The claim was rejected by the insurer on the grounds that the insured's settlement with the third party bound the insurer and prejudiced the insurer's subrogation right. Although Mr Zheng was innocent and unaware of the intricacies of the insurer's subrogation right, the law does not forgive an innocent insured, and so the court upheld the insurer's argument.

In China, as a matter of practice, the insurer's subrogation right is achieved by obtaining a "Receipt and Subrogation Form"[184] filled in and signed by the insured upon the insurer's payment under the policy. Thus, if the insured renounces the right of claim against the third party before the payment by the insurer, he will have no right to transfer to the insurer after the insurer's payment, and the insurer's subrogation right will definitely be prejudiced. In this case, the insurer is entitled to refuse the insured's claim. If the insurer has paid the insured without the knowledge that the insured had renounced his right of claim against the third party, and the insured filled in and signed the "Receipt and Subrogation Form" to the insurer, such a form is in fact not valid,

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[182] See art.44, para.1 of the Insurance Law.

[183] *Zheng Guangming v. Insurance Company*, See Hu Wenfu, Baoxian Lipei Suopei Zhinan (The guidance of the insurance claim and settlement), p. 174, China Procuratorate Press, 1993.

because the right of the insured to claim against the third party does not exist any more. The insurer is therefore entitled to claim back the moneys paid to the insured.

After payment by the insurer to the insured, whether or not the settlement or compromise agreement between the insured and the third party can bind the insurer depends on whose name will be used by the insurer to exercise his subrogation right. If the insurer exercises his right by using the insured's name, the insurer must be bound by such a settlement or agreement. If the insured waives his right of claim against the third party, the insurer's right must be lost. Under this circumstance, the insured is liable to repay the insurer.[185] If the insurer exercises the right of subrogation in his own name, any agreement or compromise can not bind the insurer and he still can make claim against or sue the third party. Because by then the insured's right of claim has already been transferred or assigned to the insurer, any agreement or compromise made by the insured with the third party is invalid.

It can perhaps be commented that the application of these rules is too harsh for an innocent insured who is not aware of the intricacies of the principle of subrogation. This is especially true in China's present situation in which most insurance consumers do not have lots of insurance knowledge, let alone an understanding of the complexity of subrogation. The above example may be taken here, if Mr Zheng had known the harshness of the doctrine of subrogation, he would not have accepted the wrongdoer's payment of a sum which was less than the actual cost of the repair of the truck. The situation represented by this case is not uncommon in China, but the Insurance Law does not deal with this matter, and it is suggested that the law should give attention to this point.

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[184] As was shown above, it is in fact a mixed form of subrogation and assignment.

[185] According to para.3 of art. 45, if the insurer is not able to exercise the right of subrogation against the third party due to the insured's fault, he may deduct a corresponding sum from the amount of indemnity when he makes the payment to the insured. Logically, if the insurer has already paid the insured, he is entitled to claim back the corresponding sum from the insured or take action against the insured.

8.2 The insured's duty in England

In England, as a general principle, subrogation rights are exercisable only in the name of the insured, so that any agreement between the insured and the third party reducing or eliminating the latter's liability will be binding on the insurer. The insurer will lose or partly lose his subrogation right if the insured renounces his right or compromises with the third party no matter whether this happens before or after the insurer's payment under the policy.

Before the insured has received the indemnity from the insurer, he has the right to sue the third party and solely control the proceedings.[186] Even after being paid by the insurer under the policy (but not the full compensation), the insured retains the right to control the action against the third party, including the right to reach a *bona fide* settlement with the third party, but there is still some danger that the insured conducts only for his uninsured loss. So the law does not allow the insured to do anything which is prejudicial to the insurer's rights of subrogation and requests the insured to conduct against the third party *bona fide* in the interests of both himself and the insurer.[187] If the insured does anything which causes the insurer's loss of his subrogation right, the insured is liable to the insurer. The insurer's remedy will be to repudiate liability on the policy, or to counterclaim for damages for the loss of, or diminution of, his rights, depending on the circumstances. The position varies slightly depending on whether the insurer has paid for the loss.[188] Before the insurer has paid the insured under the policy, any settlement or compromise made by the insured and the third party which prejudices the insurer subrogation right will entitle the insurer to set up, in response to the insured's claim, a counterclaim for damages to the amount of the loss thereby suffered by the insurer. The insurer might be entitled to repudiate liability if an express provision was made for such a contingency in the policy.[189]

After the insured has been paid for the whole loss, the question of whether a comprise agreement made by the insured with the third party may bind the insurer has been

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[186] See *Commercial Union v. Lister* (1874) 9 Ch. App.483.
[187] See *West of England Fire Ins. C. v. Isaacs* [1897] 1 Q.B. 226.
[188] See MacGillivray on Insurance Law, (9th ed.) p.552, para. 22-52. 1997.

argued. Some authorities hold that once the insured has received a full compensation either from the insurer alone or from a combination of payments by the insurer and the third party, the insured loses the right to control proceedings brought in his name against the third party, and he thus no longer has the right as against the insurer to reach any form of settlement with the third party. Even if they have made one which is *bona fide,* it does not have any legal effect on the insurer.[190] On the other hand, it has been held that the insurer who has paid out under his policy is never bound by a compromise agreement made by his insured with the third party if the third party has notice of the payment before concluding the agreement.[191] In general, it seems that the settlement between the insured and the third party would bind the insurer, because the insurer must exercise his subrogation right in the insured's name and have no better rights than the insured. Given this, any compromise agreement made between the insured and the third party would prejudice the insurer's subrogation right. The insured therefore is liable to his insurer.

8.3 Conclusion and suggestion

As was discussed above, due to the fact that the Chinese insurer may exercise his subrogation right by using his own name while the English insurer has to use the insured's name to exercise his right, the insured's duties in these two countries are slightly different. It could be suggested that if the confusion of the subrogation and assignment in the Insurance Law were clarified, the rules adopted in English law in this respect would be applicable in China.

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[189] *Ibid*, para. 22-53.

[190] If the unsolved argument left in *Napier* that the insurer has an equitable charge on the cause of action is approved this view will no doubt be correct.

[191] See *Haigh v. Lawford* (1964) 114 N.L.J 208. In this case the county court authority held that a third party who is aware that the insured has lost control of the action may not be able to plead the settlement in defence to a subrogation action by the insurer. However, this decision was disapproved of by some commentators. Professor Merkin comments: "The reasoning of the county court judge, that payment by the insurer operates as an equitable assignment of the rights of the assured so that any subsequent conduct by the assured cannot bind the insurer, has its *prima facie* attractions, but is unsound, for it is settled that subrogation rights arise before payment and in any event do not amount to an equitable assignment but merely to a right conferred upon the insurer to use the assured's name." See Merkin, Insurance Contract Law, (Loose-leaf), C.4.3-97. See also MacGillivray of Insurance Law, (9th ed.) P.552, para. 22-55.

It has been noted in both China and England, sometimes the insured is innocent, who is not aware of the complexity of the doctrine of subrogation and unconsciously prejudices the insurer's subrogation right. The question arises as to whether or not the rules should be applied to penalise such an insured. It is suggested that for a real innocent insured, he should be "forgiven" although some other questions will arise, such as how to test a real innocent insured.[192]

9. Subrogation or Abandonment

The purpose for this subsection is not to go into details of the doctrine of abandonment, but to try to construe article 43 of the Insurance Law and to clarify some of the confusions about subrogation and abandonment in the wording of this article.

9.1 Difference between subrogation and abandonment

Both subrogation and abandonment are applications of the basic rule of indemnity insurance that the insured should not receive more than a complete indemnity against his loss.[193] They are nevertheless related doctrines, and probably possess a common origin, but they are distinct. So far as abandonment is concerned, in England, it has long been a principle of equity that, where an insured under a marine policy has been paid for a total loss of the subject matter of the policy, the insurer is entitled to claim for his own benefit what remains of the subject matter.[194] In this sense, abandonment originated in the field of marine insurance. This principle was codified in the MIA 1906 (UK), and matters about abandonment are governed by sections 61 to 63 of this Act.[195] Today abandonment is frequently regarded as a sub-rule of the general

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[192] It is no doubt that there are some insureds who were aware of the doctrine of subrogation and made compromise agreement with a third party which prejudiced the insurer's subrogation right, but feigned ignorance of the doctrine of subrogation.

[193] See *Rankin v. Potter* (1873) L.R. 6. H.L. 83. 101-102 per Brett J.

[194] *Randal v Cockran* (1748) 1 Ves Sen 98; *Rankin v. Potter* (1873) L.R. 6. H.L. 83.

[195] In China, the word "abandonment" has been introduced from England. The Marine Insurance Contract Law contained in the Maritime Code 1992 was drafted largely referring to the MIA 1906 (UK). The doctrine of abandonment is codified in the Marine Insurance Contract Law in the Maritime Code. Arts. 245 to 250 of this Code give similar provisions to that stipulated in ss. 61 to 63 of the MIA 1906 (UK) which deal with the matters of abandonment.

principle of subrogation,[196] so they are easily confused. However, these two doctrines differ in a number of significant respects.

In Professor Merkin's Insurance Contract Law, five differences between subrogation and abandonment are summarised.[197] The main differences are, first, subrogation confers the right upon the insurer to use the insured's name to pursue the insured's claims against third parties for the loss of the subject matter, and therefore the insurer can not recover any more than his own payment to the insured. The excess, if any, from the recovery should be returned to the insured,[198] whereas abandonment and salvage confer the rights on the insurer over the subject matter itself and upon it the insurer becomes the owner of those goods. The insurer is, therefore, permitted to retain any profits earned by abandoned property, and he must also take over the obligation for the abandoned property. Secondly, subrogation operates automatically, by operation of law as a result of the principle of indemnity, to confer rights of action on the insurer after the payment by the insurer to the insured. Abandonment, however, is achieved when the insured tenders notice of abandonment to the insurer and the insurer accepts it. The insurer is not bound to accept the abandoned property, he may, or may not accept it. Thirdly, the doctrine of subrogation applies to all forms of

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[196] See *Dane v. Mortgage Insurance Corporation* [1894] 1 Q.B. 54 at 61, in which Lord Esher MR uses the word "salvage" as a surrogate for "subrogation". In MIA s.79(1) confused the two doctrines of abandonment and subrogation which will be discussed later.

[197] See Professor Merkin, Insurance Contract Law, (Loose-leaf), p. C.4.2 – 01, he stated: abandonment and subrogation differ in a number of significant respects:

(1) Subrogation confers the right upon the insurer to pursue the assured's claims against third parties for the loss of the subject matter, whereas abandonment and salvage merely confer rights over the subject matter itself.
(2) Subrogation does not permit the insurer to bring an action in its own name, whereas once an insurer has accepted the abandonment of goods it becomes the owner of those goods.
(3) Any profits earned by abandoned property accrue to the insurer, whereas subrogation does not permit the insurer to recover any more than its own payment to the assured, and even then only by exercising some right of action.
(4) Subrogation operates automatically, by operation of law as a result of the principle of indemnity, to confer rights of action on the insurer, whereas abandoned property apparently need not be accepted by the insurer.
(5) Subrogation is common to all forms of indemnity insurance, whereas abandonment is recognised formally only in the context of marine insurance. This is so because salvage is normally likely to be significant only where the assured has suffered a constructive total loss as opposed to an actual total loss, for in the latter case there will rarely be anything in existence to be abandoned; non-marine insurance does not of course recognise the concept of a constructive total loss. However, abandonment does operate to a limited extent in non-marine insurance, for example, where subject matter thought to be lost or destroyed turns up safe and well after the insurer has paid out in respect of it.

[198] *Yorkshire Insurance Co. Ltd v. Nisbet Shipping Co. Ltd.* [1962] 2 Q.B. 330.

indemnity insurance including marine insurance, whereas abandonment is recognised formally only in the context of marine insurance. This is so because salvage is normally likely to be significant only where the insured has suffered a constructive total loss as opposed to an actual total loss, for in the latter case there will rarely be anything in existence to be abandoned; non-marine insurance does not of course recognise the concept of a constructive total loss.

It has been held that the doctrine of abandonment also applies to non-marine insurance. Some English writers suggested that the word "abandonment" has been given a secondary meaning applicable to all indemnity insurance, namely, a rule that, on being paid for an actual total loss of the *res*, the insured is required to abandon his interest in the *res* to the insurer.[199] Thus, if a chattel is lost and then found after the insured has been paid for a total loss, the insurer is said to be entitled to have it. In addition, as a matter of practice, insurers frequently pay for a total loss following serious damage which renders repair uneconomic.[200] The second meaning of abandonment was adopted in article 43 of the Insurance Law. However, this article is ambiguous in its wording, and it confuses abandonment and subrogation.

9.2 The ambiguity of article 43 of the Insurance Law

It is stated in article 43: "Where the sum insured has already been paid in full by the insurer and such sum is equal to the insured value following the occurrence of an event insured against, all rights to the subject matter of insurance in respect of which loss was suffered shall be owned by the insurer. Where the sum insured is less than the insured value, the insurer shall take over part of the rights to the subject matter of insurance in respect of which loss was suffered, according to the ratio of the sum insured to the insured value."[201] This article obviously has both the features of subrogation and abandonment. Most Chinese writers state that the insurer's right vested by this article is " the insurer's subrogation right on things". Thus in China,

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[199] See MacGillivray on Insurance Law, (9th ed.) P. 533, para. 22-8, 1997. *Rankin v.Potter* (1873) L. R. 6 H.L. 83, 101-102 per Brett J. was cited to support this point.
[200] See MacGillivray on Insurance Law, (9th ed.) P. 533, para.22-8, 1997. See also Professor Merkin, Insurance Contract Law, (Loose-leaf), C.4.2-02.
[201] There is a same stipulation in art. 256 of the Maritime Code of the PRC, 1992.

many writers comment that the insurer's subrogation rights contains two meanings, namely the insurer is entitled, upon payment for the total loss under the policy, to (1) the insured's right of actions against the third party and, (2) the insured's rights to the ownership of the subject matter of insurance.[202] A lot of arguments have been caused in relation to the second meaning. One writer said: "the insurer's subrogation right on things arises only where the subject matter of insurance suffered a partial loss, because if the subject matter of insurance suffered a actual total loss, the ownership on the subject matter would disappear, the so-called subrogation on things would not exist."[203] Another scholar argued that: "Where the subject matter of insurance suffered a partial loss as the result of natural disaster or due to the insured's negligence, the insurer shall pay the insured on the basis of the partial loss to perform his duty of the contract, the ownership of the damaged property would not be transferred to the insurer. If the partial loss is caused by a third party, upon the payment to the insured, the insurer shall obtain the subrogation right against the third party rather than the ownership of the damaged property. So in any situation, the insurer may not get the subrogation right on the partially damaged property. The insurer's subrogation right may arise only when the insured property has been stolen and he has paid the insured under the policy."[204] Despite the different views on article 43, it is noted that all of them consider this article vests an insurer a "subrogation right on things". Assuming that the writers' views are correct that article 43 applies to subrogation, it should follow the rules of subrogation.

However, it is submitted that article 43 seems to be intended to apply the doctrine of abandonment to solve some problems in non-marine insurance. For instance, in the situation where the insured property thought to be lost or destroyed turns up safe and well after the insurer has paid out in respect of it, the insurer has right to retain it. For example, an insured motor car was stolen, the insurer paid the insured for the full indemnity under the policy, but it was found later, and the insurer, not the insured, had the right to have it. In addition, article 43 seems also to be intended to solve the problem that where the insurer pays the insured for a total loss following serious

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[202] See Yan Lixin, Baoxian Peishang Shiwu (The Practice of Insurance Indemnity), p. 191, Legal Press, 1997. See also Li Yu Quan, Bao Xian Fa (Insurance Law), p. 183, Legal Press, 1997.
[203] Xu Xuelu, Baoxianfa (Insurance Law), p. 153, 2000.

damage of the insured subject matter which renders repair uneconomic, the insurer is entitled to become the owner of the damaged subject matter of insurance if the policy is a full-insurance policy. Such a rule, in England, is considered as the secondary meaning of abandonment applicable to all indemnity insurance[205] or the application of abandonment to non-marine insurance.[206]

Article 43 deals also with matters where the property is covered under an under-insurance policy. It stipulates that the insurer can only have partial right of ownership of the lost or destroyed property insured after he has paid the insured under an under-insurance policy. For instance, a motor car was valued at RMB 60,000, and the insured sum was RMB 40,000. It was damaged seriously, the insurer paid RMB 40,000 to the insured, and the damaged car was sold for RMB 3,000. According to article 43, the insurer only has right to have RMB 2,000 (2/3 times 3,000), the RMB 1,000 should go to the insured.[207]

A number of uncertainties arise in this article. It is not clear that if the subject matter of insurance shall be automatically taken over by the insurer upon payment of a total loss, in other words, whether or not the insurer has to accept the damaged subject matter of insurance. If so, the other question is whether or not the insurer has any obligation linked to the damaged property. It seems from this article that the ownership of the damaged property is automatically transferred to the insurer from the insured after the insurer has indemnified the insured in full (where the insured is fully covered). If this is true, the problem is that even if the insured property is destroyed in its entirety or becomes worth nothing, the insurer has to accept it and bear any liability caused by it, for instance, to clear away a totally destroyed car from the road. It is obviously not fair for the insurer who paid the insured moneys and has to bear the obligation of clearing the car from the road. Another question arising from this article is of whether or not the insurer may keep the profit produced by the lost or damaged

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[204] Zhou Yongsheng, Baoxian Yu Falu (Insurance and Law), pp. 167-168, 1998.
[205] See MacGillivary on Insurance Law, (9th ed.), p. 533, para. 22-8, 1997.
[206] See Professor Merkin, Insurance Contract Law, (Loose-leaf), C. 4.2-02.
[207] It is submitted that the notion of the second half of this article is based on the stipulation of para.3 of art. 39 of the Insurance Law, which states that "Where the sum insured is less than the insured value, the insurer shall assume indemnity liability in accordance with the proportion of the sum insured to the

property. This article does not give an express stipulation. It is implied that the insurer is entitled to dispose of it in any way he wishes and retain the full proceeds even if it exceeds the payment he made to the insured, because the insurer becomes the owner of the property after he pays the insured.[208]

It is obvious that article 43 is a confusion of subrogation and abandonment. It has the characteristics of both subrogation and abandonment. Under subrogation, the insurer is automatically subrogated to the insured's right of action against the third party, and article 43 vests in the insurer such a right to take over the ownership of the insured property automatically after he has paid the insured, and he does not need to be given notice by the insured. This is the characteristic of subrogation rather than that of abandonment under which the transfer of the ownership of the insured property is achieved only when the insured gives notice of abandonment and the insurer accepts it. However, 43 also implies other characteristics which operate only under an abandonment, *i.e.* the insurer can make profit from the abandoned property, and the insurer has obligations attached to the subject matter of insurance.

The confusions of this article, it is submitted, may be affected by section 79(1) of the MIA 1906 (UK).[209] It is thus necessary to consider section 79(1) here. It is stated in this subsection: "Where the insurer pays for a total loss, either of the whole, or in the case of goods of any apportionable part, of the subject-matter insured, he thereupon becomes entitled to take over the interest of the assured in whatever may remain of the subject-matter so paid for, and he is thereby subrogated to all the rights and remedies of the assured in and in respect of that subject-matter as from the time of the casualty

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insured value, unless the contract provides otherwise." This paragraph means that where the policy is an under-insurance policy, the insured is assumed to himself be an insurer for the under-insured loss.

[208] However, in England, the Insurance Ombudsman takes the view that the insured has the right to repurchase the property, and that accordingly, the insurer must not dispose of it until the insured has been given an opportunity to repurchase it. See IOB Annual Report for 1982, at p.13; and IOB Annual Report for 1987, at pp.19 to 20.

[209] In China, Chapter 12 – the Contract of Marine Insurance - of the Maritime Code was drafted largely with reference to the MIA 1906 (UK). Art. 256 of the Maritime Code is very similar to the first aspect of s.79 (1) of the MIA 1906 (s.79 contains two meanings, the first is abandonment and the second is subrogation), while art. 43 of the Insurance Law has the same meaning as art. 256 of the Maritime Code. Due to the fact that the two distinct aspects of s.79(1) were stipulated together under the title of "right of subrogation", so the first aspect may also be regarded by some people as a subrogation right. That is perhaps the reason why most Chinese writers consider that art. 43 of the Insurance Law vests in the insurer a subrogation right but not an abandonment right.

causing the loss." This subsection, in fact, contains two aspects, those are, the insurer, upon payment for a total loss, (a) is entitled to take over the interest of the insured in whatever may remain of the subject-matter so paid for (abandonment);[210] and (b) is subrogated to all the rights and remedies of the insured in and in respect of that subject-matter as from the time of the casualty causing the loss. The first aspect involves abandonment and proprietary rights, and the second refers to subrogation right.[211] Mr Justice Diplock in *Yorkshire Insurance Co v. Nisbet Shipping Co Ltd.*[212] warned that: "It is to be noted that the subsection (referring to s.79(1)) which comes into operation only upon payment for the total loss by the insurer, deals with two distinct matters: (1) the interest of the assured in the subject-matter insured, and (2) the rights and remedies of the assured in and in respect of that subject-matter." A failure to recognise that they are distinct has caused some confusion in the law. Lord Atkin, in *Attorney-General v. Glen Line Ltd. and Liverpool London War Risks Association Ltd,*[213] drawing the distinction between the rights of abandonment and the rights of subrogation, said that "in respect of abandonment the rights exist on a valid abandonment, whereas in respect of subrogation they only arise on payment …"

As was considered above, article 43 of the Insurance Law confuses the two doctrines. This confusion must cause uncertainties for insurance business in practice or for courts in making their decision. This article, in fact, is neither subrogation nor abandonment, it is a special rule under abandonment applicable to non-marine insurance. Under these circumstances, it is suggested that this article should be amended and should be made clear on the number of uncertainties discussed above.

It could be suggested the wording of article 43 should be "After the occurrence of a total loss or a serious damage of the insured property, upon an agreement between the insured and the insurer, where the insurer pays in full for the loss, he becomes entitled to take over all the rights pertaining to the subject matter insured which is lost or

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[210] In this aspect, the phrase "becomes entitled to take over" was used. It means the ownership is not transferred from the insured to the insurer automatically. Rather he has the right to take over the subject matter of the insurance. However, art. 43 of the Insurance Law employed the phrase of "the subject matter shall be owned" by the insurer. This seems that the subject matter is automatically transferred from the insured to the insurer.

[211] See Susan Hodges, Law of Marine Insurance, p.8 Cavendish Publishing Limited, 1996.

[212] [1961] 1 Lloyd's Rep 479.

damaged. The insurer shall keep the surplus, if any. If the insured sum is less than the insured value, the insurer, upon payment, becomes entitled to take over partial right pertaining to the subject matter insured which is lost or damaged on the *pro rata* basis of the insured sum to the insured value."

10. Contractual Subrogation

Subrogation is either legal or conventional. *i.e.* it is either the creation of the law and equity or the production of an agreement by the parties in the contract. The latter is referred to as contractual subrogation as opposed to the legal subrogation. The rules governing the legal subrogation have just been considered. Now let's turn to examine contractual subrogation. Clauses which confer contractual subrogation rights are found in many of the contracts of insurance which are indemnity contracts. The intention in this section is to consider what is the relation between the contractual subrogation and legal subrogation. In this matter, there are still different approaches in different countries and regions.

10.1 The Chinese situation

In China, as a matter of practice, nearly all indemnity insurance contracts contain subrogation clauses. Some of them strictly adhere to the provisions of the Insurance Law,[214] and these clauses are undoubtedly effective and no problems arise from them. However some clauses are not consistent with the provisions of the Insurance Law and the general principle of subrogation, and they frequently extend the insurer's rights of subrogation. The question arising from the later situation is of what is the relationship between contractual subrogation and legal subrogation, and which is prevailing when the former is not consistent with the latter.

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[213] (1930) 37 Ll. L. Rep 55 at 61.

[214] Such as, in the Comprehensive Property Insurance of the Ping An Insurance Company of China, it is stipulated in s.17 that "where a third party damages the subject matter of insurance, thereby leading to the occurrence of any event insured against, the insurer shall, from the date of payment of insurance

Before discussing Chinese contractual subrogation, it is necessary first to recall the important rules of the legal subrogation described in the Insurance Law. (1) The doctrine of subrogation is the corollary of the principle of indemnity and hence it applies only to the contracts of indemnity.[215] (2) The insurer can not exercise his subrogation right until he has paid the insured.[216] (3) The insurer is not entitled to claim against a third party for any amount more than his payment. This means that the insurer can not make any windfall by exercising his subrogation rights.[217] (4) The insurer can not exercise his subrogation right against family members of the insured or any other persons comprising such family of the insured.[218] However, in practice, these rules are often ignored when insurers draft their insurance policies. In some policies the subrogation clauses extend the insurer's right of subrogation. For example, in property insurance policy, a clause states that "where a third party is held responsible for the loss or damage covered under this policy, the insured shall, whether being indemnified by the company or not, take all necessary measures to enforce or reserve the right of recovery against such third party, and upon being indemnified by the company, subrogate to the company the right of claim against the third party, transfer all necessary documents to and assist the company in pursuing recovery from the responsible party."[219] It is clear that this clause confers on the insurer the right of subrogation to control the proceedings against a third party even before the payment by him to the insured. It is also clear that this clause is contrary to the legal subrogation which does not permit the insurer to control the proceedings until he has paid the insured in full.[220] As a general principle, before the insured has been paid by his insurer, he is entitled to control the proceedings and the insurer has no right to

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moneys to the insured, be subrogaged to the insured's right to claim indemnity from a third party within the amount of the indemnity."

[215] See the Insurance Law, the matters about subrogation are provided under Section 2, Property Insurance Contract. See also art. 91(1) , it states that property insurance business includes property insurance, liability insurance, credit insurance, etc. It is implied by Insurance Law that the principle of subrogation does not apply to life insurance.

[216] See para.1 of art. 44 of the Insurance Law.

[217] *Ibid.*

[218] See art. 46 of the Insurance Law.

[219] See the policy for property all risks insurance of the Ping An Insurance Company of China. Same clauses are also provided in the policy for public liability insurance and policy for erection all risks and third party liability insurance of the Ping An Insurance Company of China.

intervene. However this clause undoubtedly increases the insured's obligation by compelling the insured to act against the third party before he has been paid by his insurer. Such action is normally made a condition precedent to the liability of the insurer. It is submitted that such a clause should not be enforceable in court.

Another example is a subrogation clause in a motor vehicle insurance policy which is more difficult to accept. The wording of this clause is: "where the insured vehicle sustains a damage or loss within the scope of the coverage for which a third party shall be held liable, the insured shall file a claim against the third party. If the third party refuses to indemnify him, the insured shall bring a legal action to the court against the third party. The insurer shall, after the insured has brought an action against the third party, indemnify the insured under the policy where the insured has made a claim in writing. The insurer shall be subrogated to the insured's rights of recovery, and the insured shall assist the insurer in pursuing recovery from the third party. Where the insurer is unable to exercise his right of subrogation due to the insured's fault or due to the fact that the insured has waived his right to claim indemnity from the third party, the insurer shall not be liable for the payment of the insurance moneys or make a corresponding deduction from the amount of the indemnity."[221] It is clear that this clause makes it a condition precedent to the insurer's indemnity liability that the insured must make a claim or bring a legal action against the third party before submitting a claim to the insurer. It imposes a harsh obligation on the insured. There is no provision in the Insurance Law thus stipulating that the insured must do such things before he claims an indemnity against the insurer, nor in the previous regulations and laws relating to the doctrine of subrogation requiring the insured to bring a legal action against the third party before the insurer indemnifies him.[222] This clause undoubtedly increases the insured's obligation and gives the right to the insurer to control the proceedings of the subrogation before he has paid the insured.[223] This

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[220] The Insurance Law does not expressly prohibit an insurer to control the proceedings before he has paid the insured, but it is so implied in art. 44 of the Insurance Law which does not allow an insurer to exercise his subrogation right until the insured has been fully indemnified.

[221] See art. 19 of the Motor Vehicle Insurance Policy of the Ping An Insurance Company of China which was put into effect on 1 July 1996.

[222] See para.3 of art. 25 of the Economic Contract Law 1981 and art. 19 of the Regulation on Contracts of Property Insurance 1983.

[223] Personal discussion with Yu Hao, the Deputy General Manager of China Insurance Company (UK) Ltd., in April 1999. But Mr Yu held the opposite view, he said: "This clause is not inconsistent with the

clause appears in the new policy which was drafted after the enactment of the Insurance Law, and the law does not vest in the insurer a right to control the proceedings before he performs his indemnity liability. Whether or not such a clause was enforceable before 1999 is not clear, because there were neither relative statutory provisions nor reported cases being found for this question, in practice, the insureds usually took action against the third party according to the requirement of the policy, before he claimed against his insurer.[224] After the enactment of the Contract Law 1999 (PRC), such a clause, which is thought to be an unfair term, should not be enforceable, because article 40 of the Contract Law expressly render a standard clause void if it exempts the party providing it from liability, increases the liability of the other party or deprives the other party of a major right.

Having considered the question of whether an express subrogation clause may modify or extend the insurer's legal subrogation right in an indemnity contract, now let's go on to discuss the question of whether an express term may vest in an insurer a subrogation right in a policy which is not an indemnity policy but has features of indemnity insurance, such as a medical treatment policy. The doctrine of subrogation applies only to the contracts of indemnity insurance and does not apply to non-indemnity insurance contracts, such as life insurance and personal accident insurance, because in such cases the insured's claim will usually be of a purely personal nature, being a claim for damages for personal injuries, so the law does not vest the insurer a subrogation right. Therefore, if an express clause appears in a non-indemnity policy which vests an insurer a subrogation right, such a clause should be totally void. However, whether or not an insurer has a legal subrogation right in an insurance contract which has both the features of an indemnity policy and a non-indemnity policy is an open question,[225] and whether or not an express subrogation clause which appears in such polices is

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legal subrogation. Such a clause also appears in the PICC's motor insurance policies, and this is a quite normal clause. All the obligations stipulated in this clause are the insured's duties for which he should perform." He also said that the motor vehicle third party liability insurance is compulsory for which the other party also must take out, so the insured should claim directly against the other party who is fault in an accident or against his insurer first.

[224] According to the interview with Mr Yu Hao in April 1999, who was the Deputy General Manager of the China Insurance Company (UK) Ltd.

[225] For the detailed consideration, see Birds, *Contractual Subrogation in Insurance*, [1979] J.B.L. 124 at 132.

enforceable is also a question at issue.[226] In China, there are indeed some such express clauses appearing in personal insurance policies. For example, in a medical treatment insurance policy, one clause stipulates: "Every claiming right against a third party who causes the loss shall be transferred by the insured to the insurer".[227] Neither reported cases nor comments have been found in China on the point of whether such a clause may vest an insurer a subrogation right, so it is submitted that it is unlikely that the court will enforce such a clause, because medical treatment policy is classified as personal insurance by the Insurance Law.[228].

In order to find solutions to these problems, approaches in other countries or regions are considered here. Policies of insurance in those countries and regions also often contain a clause setting out the insurer's rights of subrogation which, of course, are not always in agreement with the general principles of the doctrine.

10.2 The English approach and other alternatives

In England, there have been no reported cases directly dealing with this question. However, from some statements and opinions of judges and Lords of courts, it could be concluded that as a general rule an express clause should be able to alter the rules normally applicable to subrogation although they do not in general alter the insurer's right of subrogation from what the law would provide. Some writers have also given the same opinions in their books or articles.[229] For example, In *L. Lucas Ltd v. Export Credits Guarantee*[230] the Export Credit Guarantee Department provided a guarantee, which was treated by the court as equivalent to an insurance policy, covering the sale

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[226] In an American case *Michigan Medical Services v. Sharpe*, 339 Mich. 574, 64 N.W. (2d) 713 (1954), the insurer was allowed to exercise a subrogation right under an express stipulation. However in a another case of *Michigan Hospital Services v. Sharpe* 339 Mich. 375, 63 N.W. (2d) 638 (1954). involving the same parties, subrogation was not allowed in the absence of an express clause to that effect.

[227] See art. 10 of the Medical Treatment Insurance Policy of the Ping An Insurance Company of China.

[228] See art. 91 of the Insurance Law.

[229] See J. Birds, *Contractual Subrogation in Insurance*, [1979] J.B.L., pp.124-136; see also Goff & Jones, The Law of Restitution, (5th ed.) pp. 589 - 608, 1998; see also Hodgin R.W., *Subrogation in Insurance Law*, [1975] J.B.L., pp.114 -121. Note in Hodgin's article, he did not discussed particularly on the contractual subrogation, but it was mentioned; see also Derham S.R. Subrogation in Insurance Law, Chapter 13, *Express Subrogation Clauses,* pp.114-151.

of goods by Lucas & Co. Under the guarantee, the department was obliged to pay 90 per cent of the merchant's loss, but was entitled by clause 17 to 90 per cent of "any sums recovered .... in respect of a loss to which this guarantee applies ...." Clause 17 states: "Any sums recovered by the merchant or the guarantors in respect of a loss to which this guarantee applies, after the date at which the loss is ascertained, whether from the buyer or any other source shall ..... be divided between the guarantors and the merchant in the proportions of 90 and 10. ..." The Department indemnified the merchant when the loss occurred, and the merchant was paid by the buyer later. Due to a devaluation of the English pound the amount recovered, when converted into sterling, exceeded the actual loss of the merchant, so that 90 per cent of this would have resulted in a profit to the Department. The Court of Appeal held that the insurer was entitled to reap the benefits of any excess sum of money by clause 17 which excludes the application of certain principles of subrogation. The Court of Appeal's decision was reversed by the House of Lords. Unfortunately their Lordships made no reference to the general principles of subrogation but based their decision on the reinterpretation of the express provisions of the clause. Both the Court of Appeal and the House of Lords made their decision of vesting the insurer the right to and depriving his right from the benefit of the excess of money by interpreting the express clause rather than on a question of law. The House of Lords held that the correct approach was to consider the policy by reference to its terms and that it was only where some real doubt or ambiguity as to their meaning emerged that the principles of subrogation should be invoked as a guide or controlling authority to the construction of the policy. This decision clearly hinted that a clear and unambiguous express clause of subrogation may be enforced by court even it is in unconformity with the general principles of subrogation.[231]

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[230] [1974] 1 W.L.R. 909.

[231] Note: in Derham's Subrogation in Insurance Law, when he cited the decision of *L. Lucas Ltd,* he explained: "Once it is accepted that subrogation is an equitable doctrine, it should follow that the equitable rights and duties normally attaching to it should still be operative unless there is some inconsistency with the express clause." .... "On the other hand, if one were to accept that subrogation is an implied term of the contract of insurance, the fact that the parties have included an express term arguably would abrogate the need to imply a term." See also Powles, (1974) 90 L.Q.R. 34 at 38; and Birds, "*Contractual Subrogation in Insurance*" [1979] J.B.L 124 at 128. All these book and articles were written before the decision of *The Lord Napier v. Hunter* [1993] 2 W.L.R., so they all analysed this problem from two aspects of equity and implied term. If their analysis are correct, now (upon the *Naper's* decision where it was held subrogation is an equitable doctrine) it could be concluded that as a

Another example is the *Morris v. Ford Motor Co. Ltd.*, (this case was discussed earlier) in which the cleaners' right of subrogation in using the employer's name against the employer's staff was refused by the Court of Appeal. The reasoning of refusing by Lord Denning M.R. relied largely on the fact that subrogation was an equitable remedy so it was inequitable to allow the cleaners to use the employer's name to sue his own employee. James L.J. however, was of the opinion that it was an implied term of the contract of indemnity that the cleaners would not have subrogation rights. As Professor Birds commented in his article, the difference of the two reasonings is crucial in considering the relevance of the decision to a case where insurers have contractual subrogation rights.[232] It is clear that an express term may completely remove an implied term. However, if there had been an express clause of subrogation right vested to the cleaners against any third party including the employer's own employee, could the equitable doctrine combat such a subrogation right according to Lord Denning's reasoning? It is an important question after the decision of *Napier* in which it was reaffirmed that subrogation is an equitable right. Now if the employer's liability policy contains an express clause vesting the insurer a subrogation right against the employer's employee, what will the situation be? Can the court allow the insurer to exercise his right?[233] Although there has so far been no reported case in relation to this question, the operation of such an express clause may be affected by the operation of the Unfair Terms in Consumer Contracts Regulations 1999 (UK).[234] Upon the "measurement" by the "yardstick" of these Regulations, it

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general rule an express provision should be able to alter the rules normally applicable to subrogation, but they do not in general alter the insurer's right of subrogation from what the law would provide.

[232] See Birds, "*Contractual Subrogation in Insurance*", [1979] J.B.L. 124 at 133.

[233] For a discussion of some common subrogation clauses, see Birds, "*Contractual Subrogation in Insurance*", [1979] J.B.L 124. At 127-132.

[234] S.I. 1999 No. 2083. The Unfair Terms in Consumer Contracts Regulations 1999 govern the contracts which contain unfair terms except the contracts which are excluded by the regu. 4 of the Unfair Terms in Consumer Contracts Regulations 1999 (UK). Regu. 5 provides that an unfair term is one which has not been individually negotiated and which, contrary to the requirement of good faith, causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer. A term shall always be regarded as not having been individually negotiated where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term. Regu. 8(1) provides " an unfair term in a contract concluded with a consumer by a seller or supplier shall not be binding on the consumer". These regulations also apply to insurance contracts. Accordingly, any term in a consumer insurance policy which is unfair will be struck down under these regulations. For instance, if a term or clause in policy vests in an insurer a right to exercise a subrogation right or control the proceedings before he pays the insured, such term should not be enforceable.

may be regarded as unfair and be set aside on the ground of its unfairness. This matter will ultimately have to be decided by the court.

Australian insurance law has clearly settled the relationship between the insurer's legal right and contractual right. S.52(1) of the Australian ICA 1984 prohibits any "contracting out" of the operation of the Act to the detriment of a person other than the insurer (unless the inclusion of a provision to this effect is expressly authorised by the Act). Accordingly, the operation of the immunity to an employee or family members of the insured from an insurer's claim by the subrogation right stipulated in ss.65 and 66 cannot be taken away by a contrary provision in the policy.[235]

Coincidentally, the Insurance Law of Taiwan 1998 has a similar stipulation in article 54, where it states: "The mandatory provisions of this Law shall not be modified by contract; provided, however, that this rule shall not apply to modification which is favourable to the insured." Article 54(1) is a mandatory provision, it reads: "Where an insurance contract contains one of the following clauses, such provision is not valid. (a) a clause which immunises or diminishes the insurer's legal obligations or duties which are imposed on the insurer by this law; (b) a clause which deprives or limits the rights of the proposer, beneficiaries and insured vested by this law; (c) a clause which increases the obligations or duties of the insured; (d) Other terms or clauses which are apparently prejudicial to the rights of the proposer, beneficiaries or insured." It is clear that the Insurance Law of Taiwan 1998 prohibits parties to contract on terms which can exclude or mitigate insurer's obligations and deprive or limit the rights of the proposer, beneficiaries or insured, where these terms are inconsistent with the provisions of the insurance law. It is submitted that this approach is fairer to the insured and it is suggested that this approach be introduced to Chinese insurance law. Due to the fact that insurance policies are drafted by the insurer unilaterally, if there is something prejudicial to the insured's interest, such clauses should not be allowed to be effective. Further, in certain circumstances the insured has to take out the policy

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[235] S.66 of the Australian Insurance Contracts Act stipulates: "Where (a) the rights of an insured under a contract of general insurance in respect of a loss are exercisable against a person who is the insured's employee; and (b) the conduct of the employee that gave rights to the loss occurred in the course of or arose out of the employment and was not serious or wilful misconduct; the insurer does not have the right to be subrogated to the rights of the insured against the employee."

even if he does not agree with such a clause. In the case earlier mentioned of the Vehicle Insurance Policy which contains a clause vesting the insurer the right to control the proceedings even before he has indemnified the insured, the insured has no alternative but to take it as vehicle insurance is compulsory insurance in China.

It is therefore suggested that the Insurance Law should add some express provisions to prohibit the existence of express clauses in policy which to some degree prejudice the insured's interest and extend the insurer's right and which are not in conformity with the provisions of the Insurance Law or general principles of subrogation.

11. Conclusion

The Insurance Law relating to the doctrine of subrogation has been analysed in this chapter. The general conclusion is that the law is unsatisfactory in a number of aspects. Firstly, the Insurance Law confuses the concepts of subrogation and assignment (Article 44) and those of subrogation and abandonment (Article 43), consequently causes lots of problems; Secondly, there are ambiguities in the wording of the articles in the Insurance Law and a lack of definitions for some terms, such as, *bei bao xian ren de zu cheng ren yuan* (other persons comprising such family of the insured) in article 46; Thirdly, there are some lacunae in the Insurance Law in respect of the distribution of subrogation recoveries, and of whose name shall be used when an insurer exercises his subrogation right, and of rules regarding the restriction of the insurer's subrogation right against the insured employer's employee or a co-insured and so on; and finally, there are no provisions in regard to the relation of legal subrogation and contractual subrogation. It is thus suggested that the relevant articles examined in this chapter need amendment.

After examination of other countries' (mainly England and Australia, sometimes America and Canada) and region's (Taiwan) laws relating to the doctrine of subrogation, fairer solutions to the problems in Chinese law are found and it is suggested that these be introduced into China. Recommendations for amendment are therefore made which can be seen in Chapter Six.

Chapter Six: Conclusions and Recommendations

This chapter consists of two parts: a conclusion and a number of recommendations. In the first part, in addition to making a final conclusion of this study, some points regarding the relationship of the Contract Law 1999 (PRC) and the Insurance Law, which have not been covered in the previous chapters, but are important in the further understanding of the Insurance Law, are also considered. Considerations are also given to the enforcement and implementation of the Law, and the urgent requirement for amendment of the Insurance Law.

In the second part, recommendations for the amendment of provisions of the Insurance Law in relation to the three fundamental principles are made by referring to a number of better solutions from English and Australian or other countries' and regions' counterparts. It is hoped that these recommendations may present useful models for the amendment of the whole Insurance Law.

1. Conclusion

Different approaches may be used to find and solve any problem in a law. One approach is to find a problem through the actual practice of the law, and then to make any corresponding amendment to the law in order to solve the problem. For instance, the English rule regarding the test of materiality was codified in the MIA 1906 (UK), but the meaning of the phrase "would influence the judgement" was not properly discussed until 1982 in the case of *Container Transport International Inc. v. Oceanus Mutual Underwriting Association (Bermuda) Ltd.*[1], where the test of materiality was determined as the prudent insurer mere influence test, which has received criticism for its harshness to the consumers. Efforts to make it less strict to consumers were made in the following years either by common law decisions or by the so called self-regulation of the Statement of General Insurance Practice of the ABI. Another

[1] [1984] 1 Lloyd's Rep.467.

approach is to find a problem in a particular law by comparing it with another country's law, and then borrow a suitable solution from the other country to solve the problem in one's own law. In the current Chinese situation, there is an advantage in adopting the second approach, since there are mature laws around from developed countries. To wait for years or decades to come for a particular rule to be tested and a problem to be found in practice would be a big mistake. This study has demonstrated the usefulness of the second approach and also provided a model of how to use this approach to amend Chinese insurance law.

1.1 Problems found in the Insurance Law (PRC)

The enactment of the Insurance Law has significantly improved the situation in which there had essentially been no law to follow in many aspects of the Chinese insurance industry before 1995. In this sense, it represents a major advance in the process of insurance legislation in China. It also reflects the efforts of the Chinese legislator to keep the law in line with international practice. However, due to various reasons (see below), the Insurance Law is still less than mature, and a lot of problems have been found.

Three fundamental principles of insurance contract, namely insurable interest, utmost good faith and subrogation, have been fully examined throughout this work. Through comparison of Chinese approaches with English and Australian counterparts, problems of Chinese insurance law have been ascertained. The general problems of some provisions are confusion, ambiguity and contradiction, and some provisions show their unfairness. There are also some lacunae in the Insurance Law. Better solutions for these problems have been figured out by referring to English and Australian approaches. There are also some similar problems in the other areas of the Insurance Law.

So far as insurable interest is concerned, first, there is a lack of detailed provisions dealing with property insurance in the Insurance Law. Proposed suggestions are provided to fill this lacuna upon scrutiny of English and Australian laws in this respect. Secondly, provisions relating to insurable interest in life insurance in article 55 contradict article 52, so it is suggested that the second paragraph be deleted and the

scope of the first paragraph be widened. Thirdly, the ambiguity of article 63 has caused a number of disputes in relation to the beneficiary in life insurance in practice. Fourthly, the legally recognised insurable interest test is adopted in the Insurance Law and has been recognised as unreasonable to the consumers. The Australian economic or pecuniary test is submitted as more reasonable and worthwhile to follow. However, in identifying the differences between the Chinese law and English or Australian laws, it is realised that some of them are due to the fact that the relevant law in China differs from that in England or Australia. Such differences have their justification to exist. For instance, in English common law parent and children are not assumed to have insurable interest in each other, while such an interest is protected by the Insurance Law in China. This is because the Marriage Law 1980 of the PRC imposes duties on both parent and child to support each other,[2] while there is no such obligation under English common law.

In the case of non-disclosure and misrepresentation, first, the test of materiality in the Insurance Law has been determined as a prudent insurer *decisive* influence test with reference to English and Australian legal concepts in this regard, whereas the test in marine insurance has been determined as a prudent insurer *mere* influence test by virtue of the Maritime Code.[3] The latter test is unfair and needs amendment because of its harshness to the consumers. Secondly, the Chinese approach in respect of the remedy for the avoidance of the contract for an innocent non-disclosure and misrepresentation is recognised to be unfair, and the English all-or-nothing remedy is held to be unsatisfactory, while the Australian solution for remedies for negligent or innocent non-disclosure and misrepresentation is fairer and so it is suggested that this be followed when modifying Chinese law in this respect.[4] Thirdly, Chinese insurance law relieves the proposer's duty of disclosure and representation by truthfully answering the questions raised in the proposal form, but there is a lack of detailed rules to standardise the questions on proposal forms. It is suggested that the Statement of

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[2] See art. 15 of the Marriage Law 1980; see also art 21. Of the amended Marriage Law 2001 (PRC).

[3] See art. 222 of the Maritime Code. This article, basically, is a copy of s.18 of the MIA 1906 (UK), while article 16 of the Insurance Law, to a large extent, refers to article 64 of the Insurance Law 1992 of Taiwan. This inconsistency of the two tests of materiality shows an example of an unsuccessful legal transplant. See *supra* Chapter four, s. 4.5, "Materiality in marine insurance" of my thesis.

[4] The Australian approach is "if the insurer is not entitled to avoid the contract or, being entitled to avoid the contract has not done so, the liability of the insurer in respect of claim is reduced to the amount that would place him in a position in which he would have been if the failure had not occurred or the misrepresentation had not been made." See s.28(3) of the ICA 1984 (Australia).

General Insurance Practice of ABI could be followed. Fourthly, a significant gap between law and practice has been found in relation to this principle, *i.e.* some insurers do not raise any question or raise few questions about material information in the proposal form in order to gain more consumers. Thus they have to bear a higher risk but collect a lower premium than they should.[5] Finally, the basis of the contract clause which has been commonly used in proposal forms in China is a dangerous trap for consumers who are not aware of the meaning of this clause. This has been strongly criticised and restricted in its use in England and Australia. It is suggested that such a clause should be removed from the proposal forms in China.

With respect to subrogation, firstly, the Insurance Law only borrows the doctrine in word but ignores the real meaning of the doctrine. Confusions of subrogation with assignment and subrogation with abandonment are identified in the law and in practice. Secondly, some rules stemming from subrogation which have been well established in England and Australia are missing in the Insurance Law, *e.g.* the distribution of subrogation recoveries is not dealt with in the Insurance Law. It is suggested to fill this lacuna by referring to the Canadian approach[6] and Australian approach[7] which give the insured a priority to be satisfied from the proceeds recovered from a third party. Finally, contractual subrogation in some policies is not consistent with legal subrogation. The relationship between them is not stipulated in the Insurance Law which should be made clear by referring to the Contract Law 1999 (PRC),[8] the Unfair Terms in Consumer Contracts Regulations 1999 (UK)[9] and the Australian approach which prohibits any "contracting out" of the operation of the Act to the detriment of a person other than the insurer.[10]

All the three principles originated from English insurance law. They have been improving constantly in England during their evolution and they are also supplemented by common law and the Statement of the General Insurance Practice of the ABI. The Australian ICA 1984 codified common law rules and practice, and largely mitigates the common law for its harshness and unfairness. It is regarded as a model for

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[5] See Chapter four, s.12, "The gaps between law and practice in China" *supra*.
[6] See Chapter five, s. 5.3, "Other alternative approaches" *supra*.
[7] See s. 67 of the ICA 1984 (Australia).
[8] See art. 40 of the Contract Law 1999 (PRC). See also art.54 of the Insurance Law of Taiwan 1998.
[9] Regulations 4,5 and 8.

insurance law reform by English law reformers. It is therefore suggested that when China amends its Insurance Law, English and Australian insurance law can be taken as references. However, that is not to say that English law and Australian law are so perfect that no defects have been found. Criticism on some aspects of English and Australian insurance laws has been made throughout this work.

In essence, the Insurance Law is only a 'skeleton' which needs 'flesh' to supplement it. However, more than five years have passed since the enactment of the Insurance Law, and the insurance contract law is still a skeleton which awaits flesh. Neither detailed complementary rules have been made[11] nor has the Supreme People's Court's interpretation on the insurance contract part of the Insurance Law been worked out[12], although other parts of the Insurance Law (including insurance companies, insurance business rules, supervision and administration of the insurance industry, insurance agents and insurance brokers, and legal liability) have been supplemented by the Tentative Regulation on Administration of Insurance Enterprises 1996,[13] the Regulation on Administration of Insurance Agents 1997 (on trial),[14] the Regulation on Administration of Insurance Brokers 1998 (on trial),[15] and the Regulation on Administration of Insurance Companies 2000.[16] It is suggested that complementing rules on insurance contract law should be drafted by the China Insurance Regulatory Commission as soon as possible.

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[10] S.52 of the ICA 1984 (Australia).

[11] If the skeleton statute of the Insurance Law relating to an insurance contract is to be supplemented by detailed rules, these rules should be worked out by the CIRC. Most of the laws adopted by the NPC are general in nature and are therefore usually supplemented by the more detailed rules and regulations promulgated by the State Council or relevant ministries thereunder. Art. 71 of the Legislation Law of the PRC 2000 stipulates: "Ministries of the State Council, committee, the PBC, and institutions with administration function which are under direct leadership of the State Council may, according to the State Council's administrations and decisions and orders, draft regulations within their respective authorisation".

[12] There is only a textbook for interpretation on articles of the Insurance Law written by Yu Xinnian, the vice-editor of the Supreme People's Court Press. See his book of Zuixin Baoxianfa Tiaowen Shiyi (The Most Recent interpretation on the articles of the Insurance Law), 1995.

[13] It was promulgated in August 1996 by the PBC which then was the supervision and control department of the state for the Chinese insurance industry.

[14] It was promulgated by the PBC in Nov. 1997.

[15] It was promulgated by the PBC in Feb. 1998.

1.2 Reasons for these problems

(1) Historical perspectives of Chinese insurance law

As others have said, any attempt to describe the Chinese legal system merely in terms of recent legislation or legal institutions overlooks important elements of the system.[17] The political, economic and social elements of the Chinese system, under which the Insurance Law emerged, are considered in Chapter 2. Understanding those elements would help people to know the reasons for the problems in the Insurance Law. China as a whole has developed very rapidly over the last 20 years, as has its legal system.[18] Since the current legal framework of Chinese insurance law has been formed in less than two decades as compared with the century long development of some Western mature insurance law, it is not surprising that there are lots of shortcomings in the Insurance law. During the period 1949-1979, there was in essence no law to follow in the insurance industry. The administrative orders and regulations from various levels of government authorities played the role of 'law'. In fact, there was not even any domestic insurance business from 1959 to 1979, let alone any development of insurance law. The economic reform and open-door policy has, since 1978, greatly stimulated the growth of the insurance industry. The need for governing the rapidly developing insurance activities led to some attempts at insurance legislation. As a result, the Economic Contract Law 1981 (PRC),[19] the Regulation of the PRC on Properties Insurance 1983, the Interim Regulation on the Administrative of Insurance Companies 1985 and the Maritime Code 1992 (PRC)[20] were promulgated one by one. Some provisions of those laws and regulations formed the basic legal framework for governing the Chinese insurance business. However, as most of those laws and regulations were enacted in the early stage of the evolution of the Chinese economic infrastructure from a planned economy to a market economy, they were far less than adequate to handle the increasingly more complicated insurance market and business transactions. Under this circumstance, the Insurance Law was eventually promulgated

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[16] It was promulgated by the CIRC in 2000.
[17] See Kingsley T.W. Ong and Colin R. Baxter, *A Comparative Study of the Fundamental Elements of Chinese and English Company Law,* International and Comparative Law Quarterly, vol.48, p. 91, 1999.
[18] Since 1978, China has enacted 300 different sets of laws. See Wang Shengming, Rongwei Cai and Melinda Lee, An Insider's Guide to the PRC Contract Law, p.3, Asia Law & Practice, 1999.
[19] Arts. 25 and 46.
[20] Arts. 218 - 254.

by the National People's Congress on 30 June 1995 after several years preparation, and it became effective as of 1st of October 1995. It is obvious that, when this law was enacted, it was not based on the accumulation of abundant insurance practice and legal precedents. Rather, it was drafted largely based on referring to and borrowing from foreign countries' and regions' insurance laws.

(2) Drafters' lack of knowledge about how to transplant foreign law

As the Insurance Law was drafted by taking references to 16 countries' and regions' laws, it has incorporated some major internationally accepted insurance principles and practice regarding insurance contract, so it gives an impression that this law is somehow in line with international standards of practice. As Lancaster[21] commented on this Law that "to many there are a surprising number of references to familiar Western concepts of insurance, in many ways they are the result of the interaction with regulators around the world." As a matter of fact, the superficial similarities in words with some Western concepts conceal the underlying differences in values of the concepts. The Insurance Law adopts some doctrines which originated in England, such as the three principles of insurable interest, non-disclosure and misrepresentation, and subrogation which present immediate examples of English legal fiction. However it seems that the Insurance Law borrows only the doctrines in words, not the real meaning of the doctrines in their original country, and some rules stemming from the doctrines or the ways of the application of the doctrines are ignored. Thus some confusions, ambiguities, contradictions and lacunae appear in the contract part of the Insurance Law. These problems were, to some extent, due to the fact that the drafters of the Insurance Law were somewhat ignorant of the rules of legal transplant. (See 1.6 below).

(3) Legislative perspective

Unlike the English common law system where statutory laws are made by codifying case law and rules of practice, China has a civil law system, in which the statutory law comes partly from the codification of previous norms, rules and customs and partly

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[21] Mr. Ian Lancaster, the vice president or regional manager for greater China, Chubb Group of Insurance Companies. http:/www.chubb.com/China/laws/inslaw-commentary.htm.

from the adoption of other countries' or regions' laws. Judicial precedent has little or no effect on the formation of new laws. Especially, in the realities of today in China, the legal system has only been re-established since 1978, so there are, in fact, not many precedents which may give any effect to new legislation. On the other hand, as Professor Lubman noted in his book on Chinese legal reform: "the Chinese situation seems anomalous when compared with the development of commercial law in the West, where legal rules emerged out of centuries of commercial custom and practice. In China today, by contrast, rules are being adopted even while new transactions are themselves emerging and before much experience has been accumulated about them."[22] This vividly describes the current situation of Chinese legislation. The insurance legislation is a ready example. After it had been suspended for 20 years, the insurance business was reopened in 1979, and before much insurance practice and experience had been accumulated, the Insurance Law was enacted. In Western countries, such as England and Australia, rules and common law decisions are codified in statutes after several centuries' practice and experience. For insurance, the MIA 1906 (UK) codified rules which stemmed from common law and insurance practice, and the ICA 1984 (Australia), in general, codified common law rules (with reform) and long term practice in the context of insurance. However, the lack of any real body of case-law and the dearth of an accumulation of customs and experience render Chinese laws more likely to have certain shortcomings and even mistakes.

1.3 Contract Law 1999 v. Insurance Law 1995

The relationship of the Contract Law and the Insurance Law is a relationship of general law and special law. In the Chinese legal system, special law prevails over general law, special provisions prevail over general provisions.[23] The Contract Law 1999 is a basic law, *i.e.* a general law, of China. It also contains provisions on special contracts which have not been drafted separately. Following the principle of interpretation, the Contract Law makes it clear that in the event of other laws having other provisions relating to contracts, such other laws shall prevail over the Contract

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[22] See Lubman Stanley B. Bird in A Cage - Legal Reform in China after Mao, p.175, 1999.
[23] See art. 123 of the Contract Law 1999. See also Wang Guiguo, Wang's Business Law of China, (3rd ed.), p. 162, Butterworths Asia, Hong Kong, Singapore, Malaysia, 1999.

Law.[24] The Insurance Law is a special law which is followed by parties who are engaged in insurance activities. For matters the Insurance Law does not deal with, the Contract Law operates.

The Contract Law 1999 has an impact on the Insurance Law. Some provisions which are stipulated in the Contract Law fill the gaps in the Insurance Law. For instance, in the Contract Law, an unfair term drafted by a party unilaterally in a contract is prohibited to become effective, as article 40 stipulates: "……, a standard clause of a contract is void if it exempts liability of the party providing it, or increases the liability of the other party, or deprives the other party of a major right." In the Insurance Law there is no such provision, so where an unfair term appears in an insurance contract,[25] no law was followed to solve this problem before the enactment of the Contract Law. For example, as was discussed earlier, a motor vehicle insurance policy contains an unfair term which imposes an extra duty on the insured to bring a legal action to the court against a third party who caused the insured loss before the insurer has paid the insured.[26] Now such a term may not be enforceable under article 40 of the Contract Law. The Contract Law also introduces the rule of paying damages to the party who suffered a loss caused by the other party because of dishonesty or fraudulence or untrustworthiness, as article 42 provides: "A party who causes loss to the other party is liable for damages under any of the following circumstances during the course of concluding the contract, (1) negotiated in bad faith under the pretext of concluding a contract; (2) deliberately concealed material facts relevant to the conclusion of the contract or provided false information; (3) engaged in other acts counter to the principle of good faith." This provision imposes the legal consequence on the party who does any of the actions prohibited by this article. While the Insurance Law does not provide such a remedy, it is suggested that for matters which the Insurance Law fails to deal with, parties to an insurance contract should be governed by the provisions of the Contract Law, and, when the Insurance Law is amended, these provisions should be added into the Insurance Law.

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[24] Art. 123 of the Contract Law 1999.
[25] An insurance contract is a typical contract drafted by the insurer unilaterally.
[26] See art. 19 of the Motor Vehicle Insurance Policy of the Ping An Insurance Company of China. Other Chinese insurance companies' Motor Vehicle Insurance Policies also contain such a term.

The Contract Law is a more comprehensive and unified legislation governing contractual activities than were the previous laws relating to contracts. It was drafted on the basis of the earlier sets of laws on contracts, such as the Economic Contract Law 1981 (amended in 1993), the Foreign Economic Contract Law 1985 and the Technology Contract Law 1987, and unified the three inconsistent legislations.[27] Provisions in the new Contract Law are more definitive than the cryptic provisions found in the earlier sets of law on contract. It also codifies administrative rules, judicial interpretations and practice that have been effective in recent years.[28]

1.4 Urgency for amendment and supplementation of the Insurance Law

In several senses, the amendment and supplementation of the Insurance Law is urgently needed. On the one hand, so far as the Law itself is concerned, many confusions, ambiguities, contradictions and much unfairness have been found in the law which have caused lots of disputes and arguments in practice. There are also some lacunae in the Insurance Law. For example, the law does not mention at all the doctrine of proximate cause which is commonly applied internationally, and no law can be followed in this aspect. On the other hand, due to the fact that the Insurance Law was being gestated and shaped during the period when China's economic system was transforming from a planned economy to a market economy, everything was changing greatly and the law was difficult to make with the long view in mind because of such a changing society. Even now, while China is experiencing rapid economic and social change, the law should keep pace closely with the rapid development. This is unlike the situation in some Western countries, where a century-old legislation may still be current, such as in England, where the LAA 1774 and the MIA 1906 are still in force today.

Moreover, after joining the WTO (it is hoped this may happen in the near future), China has to perform its obligations according to the requirement of the GATS. Art. XVI (2)(a) of the GATS stipulates that "member states are not to maintain or adopt limitations on the number of service suppliers in the form of exclusive service

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[27] The new Contract Law repeals the three sets of laws by art. 428 of the new Law.
[28] See Wang Shengming, Rongwei Cai and Melinda Lee, An Insider's Guide to the PRC, Contract Law, p.6, Asia Law & Practice, 1999.

suppliers". As one of the prerequisites of joining the WTO, China must commit itself to completely open its insurance market to foreign countries. Also, the Regulation on the Administration of Insurance Companies 2000 stipulates that foreign insurance companies, which, upon obtaining permission, establish insurance branches in China, shall follow this regulation unless otherwise provided by other law or regulation.[29] This means that foreign insurance companies will be treated the same as national insurance companies. There is no limitation for them to transact insurance business in China. Thus, a free market will be created in China for foreign insurance companies in the near future.[30] This necessitates a further improvement in Chinese insurance law to cope with the new situation by keeping legislation in line with international standards and conventions. Under this circumstance, the legislative principle of tailoring the law to China's own circumstances should be transferred to tailoring the law to international standards and China's own circumstances. Using current international standards and practices to bring domestic rules of law in line with the international trend is the direction and essential content of domestic law reform. In this study, through comparing the Chinese insurance law with its English and Australian counterparts, I have demonstrated with convincing evidence that there are some things in the Insurance Law out of the line with international standards. In this sense too, the Law needs to be amended and supplemented urgently.

Unfortunately, there is no sign of an immediate amendment or supplementation of the insurance contract law. Several possible reasons could be suggested for this fact. First, the law has been in force for only five years, so it may need a longer time to test if it will work well in practice. Secondly, in recent years most of the Chinese authorities, legislators or commentators have concentrated most of their attentions on insurance regulations, but less on insurance contract law. More articles have been found on the topics of how the China's insurance market will change after China joins the WTO and how to cope with the situation, but less on the topic of insurance contract. Thirdly, because the number of insurance companies in China has increased rapidly, the government and the CIRC concentrate on how to regulate and supervise insurance enterprises. Fourthly, it may also be indirectly related to Chinese

[29] See art. 115.

approaches in dispute handling. In China, civil or commercial disputes are usually solved by four methods, reconciliation between the parties themselves, mediation by a third party, arbitration, and the last resort - legal action.[31] Most cases are settled in the first three procedures, fewer are submitted to courts. Chinese are not used to calling on courts to resolve disputes. Even in courts, judges use the mediation function first before they make their judgement according to statute law.[32] So the opportunities of judges using the rules of law to settle disputes are reduced, and hence there are fewer opportunities for the rules of insurance contract law to be tested in courts. Consequently, there is a delay in finding out the problems which still exist in parts of the insurance contract of the Insurance Law.

1.5 Implementation of insurance law

Whether or not the law would function in the way the legislators expect depends not only on how the law is written but also on how the law is implemented. Without an effective and transparent implementation, any law would have little practical value even if it were a good law. This point has particular meaning to the Chinese situation. A foreign visitor often heard a Chinese version of a world-wide lament "We have good laws, but they are badly implemented."[33] There are several factors which may affect the effective implementation of the Insurance Law. First, as far as the enforcement of law in courts is concerned, judges sometimes cannot play their roles properly. Factors which limit the influence and power of Chinese judges are their generally poor levels of legal training, their links to local political and administrative structures, and their

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[30] Ma Yongwei, the CIRC's president, told domestic and foreign journalists during a press conference Novermber 18, 1999 that: "There will not be any restrictions for foreign insurers to enter China's market after China joins the WTO." See Insurance Research Letter, Far East – 5, Feb. 2000.

[31] The Contract Law 1999 (PRC) provides that disputants should first attempt to settle disputes through mediation and failing that, through arbitration; litigation is authorised only if the parties do not have a valid arbitration agreement. See art. 128.

[32] In the Civil Procedure Law 1991 (PRC), the power to mediate a civil case is conferred on people's courts by the provisions in arts. 85-91. In many cases, it appears that the courts have more or less imposed a mediated settlement on the parties. This is in contrast to the common law courts. As I witnessed in an insurance subrogation case in the Maritime Court of Qingdao in May 2000, the judge first mediated the case, making the Fujian shipping company (the third party wrongdoer) pay 70% of the amount of the subrogation claim to the PICC Qingdao Branch, but the shipping company did not agree. The judge then settled the case strictly according to the statute law by deciding the shipping company should pay 100% of the amount to the PICC, Qingdao Branch.

[33] See Ann Seidman & Robert B. Seidman, *Drafting Legislation for Development: Lessons from a Chinese Project,* American Journal of Comparative Law, p. 9, 1996.

relatively low status and their low incomes.[34] The judiciary in China is an integral part of the system of government. Courts exist at the national, provincial and local levels and, as Du and Zhang pointed out, "judicial institutions in China function under the unified leadership of state institutions of power. Therefore, judicial independence exists only in regard to other institutions of state power."[35] Judge's decision on cases, to a certain extent, are influenced or restricted by bureaucratic powers.

Secondly, in China the sacred judicial palace – the court - is not unaffected by corruption. Judges themselves are sometimes bribed by solicitors or the parties who are involved in the case. Whether or not a party involved in a case can win the case, sometimes depends on whether or not he has a connection (*guanxi*) with the judge who is dealing with the case or with other personnel in court who can lobby the judge.

Thirdly, the incompetence of Chinese judges impairs the effective implementation of Insurance Law. On the one hand, judges lack high education. Throughout the 1980s most of China's judges came to their positions through transfer from Party and military posts. Most lacked a university education, and very few had received formal legal instruction. Objective qualifications for all judges were not formally established until the Judges Law (PRC) was promulgated in 1995, in which it is stipulated that judges must meet the following qualifications, *inter alia*: (1) a college graduate majoring in law who has been employed for at least two years or a college graduate not majoring in law but who received professional legal training and has been employed for at least two years; or (2) a holder of LL.B degree who has been employed for at least one year and holders of LL.M or LL.D degree. Since the enactment of the Judges Law, the situation of the incompetence of judges has been gradually improved. On the other hand, judges lack insurance knowledge. Some judges who deal with insurance cases have a general legal knowledge but lack enough insurance knowledge, and this limits them in exercising their judgement and gives rise to more chances of making wrong decisions on insurance cases.

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[34] Roman Tomasic, Company Law in East Asia, p.140, Ashgate, 1999.
[35] Du, X and L. Zhang, China's Legal System: A General Survey, Beijing: New World Press, p. 81, 1990.

Fourthly, so far as China's insurance industry is concerned, most of the staff in insurance companies are not adequately trained, so they sometimes do business not by following insurance law or insurance regulations due to their incompetence in the job. Even some managers of insurance companies have little knowledge about insurance law. They may have some experience of managing an enterprise, but are not competent managers for an insurance company. Among them, some only worked in an insurance company for two or three years before they were promoted to an important position, and some did not even have any insurance knowledge at all before they were appointed as managers in insurance companies.[36] The situation considered above was quite understandable because of the lack of skilled human resources when the development of China's insurance industry was at its beginning in the earlier 1980s. Even today the situation still continues, for the new born insurance companies emerging one after another, and foreign insurance companies, all employ local Chinese to work for them, because these companies need a lot of staff.[37] The serious lack of qualified human resources in China's insurance industry and the incompetence of some mangers and staffs may cause many difficulties for the implementation of the Insurance Law. This situation is significantly different from some Western countries such as England where the managers and employees in the insurance companies are competent for their jobs. The managers of English insurance companies generally understand insurance laws well and have abundant insurance experience. Some of them have worked in insurance companies for several decades. The new employees in English insurance companies have been well educated and trained before they start their careers.[38]

Moreover, some Chinese insurance companies transact business by undue means in order to win more consumers, *e.g.* by paying higher commission fees to the agent than what the regulation allows.[39] And also, during the negotiation of the contract or in the process of claiming, some insurance staff and consumers jointly do something

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[36] For example, some former army officials were appointed as managers to insurance companies as soon as they left the army.

[37] I witnessed this situation when I worked in the PICC, Qingdao branch between 1984 and 1990, and in Hua Tai Insurance Company of China limited, Qingdao branch in 2000.

[38] Personal discussion with Professor J. Adams.

[39] For example, the CIRC stipulates that the commission fee shall not exceed 7 percent of the premium received by them, but in fact the agents are given by some insurance companies even more than 30% of the premium received by them.

malfeasant which the law prohibits.[40] These actions should be strictly controlled or immediately prohibited by the China Insurance Regulatory Commission. However, due to the fact that this Commission is a new insurance regulatory body, the shortage of personnel, the lack of experienced supervision and the incompetence of some staff make the Commission unable to function properly.

Steps should be adopted by government to solve the above problems in order to ensure the insurance law being implemented effectively. Otherwise, there will be little difference between a good law and a bad law in terms of their practicality.

1.6 Points relating to legal borrowing

Comparative law has many functions.[41] One of the functions is that the comparative law can be used as an aid to legislation and law reform. This function is often used by developing countries to draft their new laws or reform their existing laws, especially for a changing society, like China today. Comparative law provides the central method used in aiding not only the drafting of Chinese Laws but also the amendment or reform of the Laws. This method was also used to assist the drafting of the Insurance Law. Similarly, my research adopts this method to help me recognise problems and make recommendations for the amendment of the Insurance Law. In current Chinese situation when its legal reform is being undertaken, China needs and has the advantage of being able to learn and borrow ideas from the experience of other countries that have mature laws and regulations. Looking back at the path of China's legal reforms over the last 20 years, China has demonstrated its willingness to do so in establishing a suitable legal system for strengthening the socialist market economy.

However, when using this method to draft or reform local laws, precautions should be taken to avoid superficial or misguided transplants. Although it may be difficult and unnecessary to understand the whole legal system of the country from which one

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[40] For instance, some staff induce the proposer not to perform his duty of disclosure of material information during the negotiation of the contract, or promise the proposer, the insured or the beneficiary a rebate on the insurance premium or other benefits not provided for in the insurance contract, or pay a fraudulent claim. All these are strictly prohibited by the Insurance Law and insurance regulations. See arts. 105 and 131 of the Insurance Law.

[41] See Peter de Cruz, Comparative Law in A Changing World, (2nd ed.), p. 18, Cavendish Publishing Ltd, London, 1999.

wishes to borrow some legal rules or ideas, nevertheless it is important and absolutely necessary to understand that particular piece of law which one wishes to introduce into one's own country's law. One must thoroughly understand the meaning of the rules not only the words of the rules, but also their values and underlying principles, as well as the implementation, the constraints, limitations and extensions of the rules in the country-specific circumstances. Otherwise, one may transplant the foreign rules superficially, but leave the essence of the rules behind. For example, the principle of subrogation is adopted in the Insurance Law, but the meaning of the principle embodied in the Insurance Law is confused with the doctrine of assignment. Some rules arising from the principle, such as whose name should be used when the insurer exercise his right of subrogation, or when the insurer may control the proceedings of actions, are not stipulated in the Insurance Law. Thus certain disputes have been caused in practice. Yet again, laws which are not satisfactory in the original countries or which have been proved satisfactory in those countries, but not suitable to the Chinese situation, would not be recommended for transplanting into China. For example, the Australian approach in respect of the test of materiality is "reasonable man" test which is welcomed in Australia, but it not suitable to the Chinese situation, so it is not considered appropriate to adopt it in China.[42]

It has been proved that it is easy to borrow the provisions or concepts of foreign laws, but it is difficult to learn their values and essence and incorporate them in one's own laws. To grasp the basic values and real essence of a law is the main task of a law drafter and law reformer when learning foreign laws.

2. Recommendations

Having made the conclusion, it is now the proper stage to set out some recommendations for amendment to the provisions relating to the three principles in the Insurance Law which is the ultimate goal of this study. It is hoped that these recommendations may provide a useful model for the reform of the whole Chinese insurance contract law.

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[42] For more details see Chapter Four, s. 4.3, p. 188.

It is proposed that the relevant provisions be amended as shown below. The words in bold type denote the recommended amendments, and the words enclosed in square brackets denote the original versions which it is suggested should be replaced by the recommended amendments.

2.1 Recommendation for amendment to articles relating to insurable interest

(1) Paragraph 2 of article 52 is ambiguous, article 52 and article 55 are contradictory, and it is suggested that the first paragraph of art.52 should be retained and widened, but the second paragraph should be abolished. It may be amended as follows:

A proposer has an insurable interest in the following persons:

(1) himself;

(2) his spouse, children and parents;

(3) a person on whom the proposer depends, either wholly or partly, for maintenance and support;

(4) a person upon whose death the proposer is likely to suffer a pecuniary or economic loss.

The limits of the insured amount shall be determined by the Financial Supervision and Control Department.

[Comparing to article 52 of the Insurance Law:

A proposer shall have an insurable interest in the following persons:

(1) himself;

(2) his spouse, children and parents; and

(3) members of his family and close relatives other than those mentioned in the preceding item who are in the relationships of fostering or raising or supporting with him.

In addition to the persons mentioned in the preceding paragraph, the proposer shall be deemed to have an insurable interest in any insured person who agrees with the proposer to conclude a contract on his life.]

(2) As to article 60 which contradicts article 54, it is suggested that it should be amended as follows:

The beneficiary of a life policy shall be designated by the life insured or the proposer. The consent of the life insured shall be required when the proposer designates a beneficiary.

Where a parent effects a policy on his minor child, the beneficiary should be designated by the child's legal guardian subject to article 54.

[Comparing to article 60 of the Insurance Law:
The beneficiary of a life policy shall be designated by the life insured or the proposer. The consent of the life insured shall be required when the proposer designates a beneficiary.

Where the life insured is a person without or with limited capacity for civil acts, the beneficiary may be designated by his guardian.]

(3) As to article 63, it is not ambiguous of itself, but a lot of arguments arise in practice involving this article. In order to overcome this problem, it is suggested that this article should be left as what it is and a supplement be added to it. It may be amended as follows:

Upon the death of the life insured, the insurance money shall become part of the life insured's estate, and the insurer's obligation to pay insurance moneys shall be performed in favour of the life insured's successors under any of the following circumstances:

(a) where no beneficiary has been designated;

(b) where there is only one beneficiary, and such beneficiary dies prior to the death of the life insured; or

(c) where there is only one beneficiary, and such beneficiary loses or waives his beneficiary right according to law.

The life insured's estate successors shall be determined at the time when the life insured dies.

[Comparing to article 63 of the Insurance Law:

Upon the death of the life insured, the insurance monies shall become part of the life insured's estate, and the insurer's obligation to pay insurance monies shall performed in favour of the life insured's successors under any of the following circumstances:

(a) where no beneficiary has been designated;

(b) where there is only one beneficiary, and such beneficiary dies prior to the death of the insured; or

(c) where there is only one beneficiary, and such beneficiary loses or waives his beneficiary right according to law.]

(4) So far as property insurance is concerned, there is no special provision relating to the requirement of insurable interest in property insurance except article 11 which is for all types of insurance. Some recommendations are made as follows:

(a) It is suggested that the "legally recognised interest test" of insurable interest should be replaced by an "economic or pecuniary test". Consequently, the definition of insurable interest described in article 11 of "insurable interest shall refer to a legally recognised interest of the proposer in the subject matter of insurance" should be removed, and a new article should be inserted in Section Two "Property Insurance Contract" of the Insurance Law:

Where the proposer under a contract of property insurance has suffered a pecuniary or economic loss by reason of that property, the subject-matter of the contract, has been damaged or destroyed, the insurer is not relieved of liability under the contract by reason only that, at the time of the loss, the proposer did not have an interest recognised by law.[43]

(b) For a property policy, it is not necessary to require a proposer to have an insurable interest at the time of the inception of the policy. The reasons for this were given above. It is therefore suggested that a rule to govern this matter be established:

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[43] This article is recommended after referring to s. 17 of the Australian ICA 1984. The term "general insurance" is changed to "property insurance", because in the Insurance Law, property insurance business include insurance business such as loss of property insurance, liability insurance, credit insurance, etc." See art. 91 of the Insurance Law.

The proposer who effects a property insurance policy for his own benefit must be interested in the subject-matter insured at the time of the loss, though it is not necessary for him to have an interest when the policy is effected.[44]

(c) If the suggestion of the economic interest test for insurable interest is accepted, another article about insurance effected on the behalf of other persons should be added:

Where the proposer and other persons each have an interest in the property insured against, the proposer is allowed to insure the property for its full value for his own interest and other persons' interests if the proposer intended to do so when the policy was effected.

Where the event insured against occurs, if the amount of the loss exceeds the amount of his own loss, the proposer may recover the full amount of the loss and keep the amount which represents his own interest and account for the surplus to the other persons. Alternatively, both the proposer and the other persons may recover against the insurer for their own separate loss.

Where two or more persons have different interests in a property, a co-insurance policy may be effected. Each co-insured is presumed to have an insurable interest in the whole property and each of them may claim directly against the insurer. Each co-insured is immune from the insurer's subrogation action.[45]

(5) So far as insurable interest in marine insurance is concerned, the suggestion is that the above recommended articles relating to property insurance apply to marine insurance. Additionally, another article should be added into the Maritime Code by borrowing section 7 of the MIA 1906 (UK) in regard to defeasible or contingent interest. It reads

(a) A defeasible interest is insurable, as is also a contingent interest.

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[44] This article is recommended after referring to the English insurance law relating to insurable interest in goods and insurable interest in marine insurance, (see s.6 of MIA 1906) as well as the Australian approach to insurable interest in general insurance, (see s. 16 of the Australian ICA 1984).

[45] This article is recommended after referring to the English common law approach about limited interest and co-insurance and the approach of Australian ICA 1984, s.49 coupled with my own ideas.

(b) In particular, where the buyer of goods has insured them, he has an insurable interest, notwithstanding that he might, at his election, have rejected the goods, or have treated them as at the seller's risk, by reason of the latter's delay in making delivery or otherwise.

2.2 Recommendation for amendment to articles relating to non-disclosure and misrepresentation

(1) It is recommended that the principle of utmost good faith should be codified in the Insurance Law by defining it as follows:

(a) An insurance contract is a contract based on the utmost good faith, by which it is implied that each party should act towards the other party, in respect of any matter arising under or in relations to it, with the utmost good faith;

(b) The duty includes the requirement that the insurer brings to the proposer's attention the general nature and effect of his/her obligations under the contract; failure to do so will mean the insurer cannot rely upon a breach by the proposer.

(2) As to non-disclosure and misrepresentation by the proposer, it is suggested that article 16 of the Insurance Law needs to be amended as follows:

When concluding an insurance contract, an insurer shall explain the details of the terms and conditions of such contract to the proposer and may raise questions concerning relevant details of the insured subject matter, or of the insured. The proposer shall truthfully answer the questions inquired by the insurer. If the proposer or the insured fails to perform such duty, and withholds or gives an incorrect representation of material information, relevant consequences shall be imposed. Information is material which would sufficiently influence a prudent insurer's decision on whether he will accept the insurance or raise the premium rate.

(3) The remedies for non-disclosure and misrepresentation should be provided in separate article, as recommended below:

(a) If the failure of disclosure or misrepresentation was fraudulent, the insurer may avoid the contract retroactive to the very beginning of the contract, and

may retain the premium the proposer has paid. The proposer or insured who fraudulently breaches the duty shall be punished financially.

(b) If the failure of the disclosure or misrepresentation was not fraudulent, the insurer is not allowed to avoid the contract simply, instead:

Before the occurrence of the event insured against,

(i) the insurer may avoid the contract where he would have refused the insurance altogether had he known the correct fact, and return the premium the proposer has paid;

(ii) the insurer is not allowed to avoid the contract if he would not have refused the insurance altogether but would have raised the premium rate if he had known the true fact, instead he may charge more premium to the amount he would have charged had he known the correct fact;

After the occurrence of the event insured against,

(i) the insurer may deny the liability, avoid the contract and return the premium the proposer has paid where the insurer would have refused the insurance altogether had he known the correct fact;

(ii) the insurer is liable to pay the amount under the policy corresponding to the premium the proposer has actually paid where the insurer would not have refused the insurance altogether but would have charged a higher premium had he known the correct fact.

(c) where there has been a relevant non-disclosure or misrepresentation, the insurer has no remedy in the following situations:

(i) if the insurer's decision would not in fact have been any different had the fact been disclosed.

(ii) an untrue statement made by the proposer is not regarded as misrepresentation if he honestly believed it to be true on a reasonable ground.

[comparing to article 16 of the Insurance Law:

"When concluding an insurance contract, an insurer shall explain the details of the terms and conditions of such a contract to the proposer and may raise questions concerning relevant details of the insured subject matter, or of the insured. The proposer shall truthfully disclose such details to the insurer.

The insurer shall have the right to rescind the insurance contract where the proposer withholds facts at ill will and fails to perform his duty of disclosure and truthful representation of information to the insurer or fails to perform such duty as a result of a mistake so that the failure of disclosure or representation shall sufficiently influence the insurer's decision on whether or not he will accept the insurance or raise the premium rate.

Where the proposer fails to perform his duty of disclosure and truthful representation of information to the insurer at ill will, the insurer shall not be liable for payment of insurance moneys in connection with events insured against that occur prior to the rescission of the contract, and shall not refund the premium.

Where the failure of the proposer to perform his duty of disclosure and truthful representation as a result of a mistake has a serious impact on the occurrence of events insured against, the insurer shall not be liable for payment of insurance moneys in connection with events insured against that occur prior to the rescission of the contract, but he may refund the premium."]

(4) It is suggested that the Insurance Law should include an article about waiver of disclosure as follows:

Where a person failed to answer; or gave an obviously incomplete or irrelevant answer to a question included in a proposal form about a matter which is accepted without inquiry by the insurer, or where the insurer has discovered the non-disclosure or misrepresentation by the proposer, but the insurer accepted the proposer's application for the insurance, the insurer shall be deemed to have waived compliance with the duty of disclosure in relation to the matter.

(5) With reference to ABI's Statement of General Insurance Practice in respect of the proposal form, some complementary rules as to non-disclosure and misrepresentation are recommended to be put into practice in China:

(i) A statement should be prominently displayed on the proposal form:

Drawing the attention of the proposer to the duty of disclosure and truthful representation and the consequences of a breach of the duty, explained as those

facts an insurer would regard as those which would sufficiently influence his decision on whether or not to accept the risk or what premium to be charged;

(ii) Those matters which insurers have found generally to be material will be the subject of clear questions in the proposal form. The language should be in plain Chinese which an ordinary person can easily understand. Where they are transferred to English, it should be in plain English which an ordinary foreigner can easily understand.

(iii) In proposal forms, insurers will avoid asking questions which would require expert knowledge beyond that which the proposer could reasonably be expected to possess or obtain or which would require a value judgement on the part of the proposer.

(6) Other recommendations:

(a) Renewal notices shall contain a warning about the duty of disclosure including the necessity to advise of changes affecting the policy which have occurred since the policy's inception or last renewal date, whichever was the later.

(b) The duty of disclosure is required when a suspended life policy is restored after the agreement of the insurer and insured has been reached.

(c) An insurer will not repudiate liability on the grounds of non-disclosure of a material fact which a proposer could not reasonably be expected to have disclosed; nor on the grounds of misrepresentation, unless it is a deliberate or negligent misrepresentation of a material fact.

(d) To abolish the application of the "the basis of contract" clause in proposal forms.

(e) Remedy for a breach of the duty of disclosure by an insurer should be an awarding of damages to the insured.

2.3 Recommendation for amendments to articles relating to subrogation

(1) Article 44 of the Insurance Law confuses the doctrines of subrogation and assignment, and there is a lacuna in respect of distribution of the recoveries between the insured and the insurer for their competing claims. This article may be amended as follows:

(a) Where a third party damages the subject matter of insurance, thereby leading to the occurrence of an event insured against, the insurer shall, after payment of insurance moneys to the insured, be subrogated to the insured's right to claim indemnity from the third party.

(b) Where the insurer exercises the right of subrogation against the third party, he shall use the insured's name, and claim for the full loss the insured has suffered. Among the recoveries, the insured shall have priority to make up the portion which is excluded from the insurance cover (such as an excess or under-insurance or average clause), the surplus shall go to recoup the insurer's payment to the insured.[46]

(c) Where the insured takes action against the third party, if he wishes, he must do it in good faith and conduct for the whole loss. If he has obtained damages from the third party before the insurer's payment, the insurer shall, at the time of paying the insurance moneys, deduct such amount recovered from the third party. If the insured has received damages from the third party after the insurer's payment, he is liable to account to the insurer the surplus after his full compensation for his loss.

[Comparing to article 44 of the Insurance Law:

Where a third party damages the subject matter of insurance, thereby leading to the occurrence of an event insured against, the insurer shall, from the date of payment of insurance monies to the insured, be subrogated to the insured's right to claim indemnity from a third party within the amount of indemnity.

Where the insured has already obtained indemnity from a third party following the occurrence of an event insured against as mentioned in the preceding paragraph, the insurer may, at the time of paying the insurance monies, deduct an amount equivalent to such indemnity obtained by the insured from the third party.

The insurer's exercise of his right of claim by subrogation in accordance with the first paragraph shall have no impact on the insured's right to claim indemnity from the third party for the portion which has not been indemnified.]

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[46] This amendment is recommended after referring to English common law relating to subrogation and assignment and the Law of Property Act 1925 (UK) s.136 which deals with the doctrine of assignment,

(2) As to article 43 which confuses the doctrine of subrogation and abandonment, it is suggested that it be amended as follows:

After the occurrence of a total loss or a serious damage of the insured property, upon an agreement between the insured and the insurer, where the insurer pays in full for the loss, he becomes entitled to take over all the rights pertaining to the subject matter insured which is lost or damaged. If the insured sum is less than the insured value, the insurer, upon payment, becomes entitled to take over partial right pertaining to the subject matter insured which is lost or damaged on the *pro rata* basis of the insured sum to the insured value. [47]

[Comparing to article 43 of the Insurance Law:

Where the sum insured has already been paid in full by the insurer and such sum is equal to the insured value following the occurrence of an event insured against, all rights to the subject matter of insurance in respect of which loss was suffered shall be owned by the insurer. Where the sum insured is less than the insured value, the insurer shall take over part of the rights to the subject matter of insurance in respect of which loss was suffered, according to the ratio of the sum insured to the insured value.]

(3) Article 46 of the Insurance Law puts restrictions on the insurer's right of subrogation. It is suggested that this article should be amended, with reference to the English "gentleman's agreement", Canadian and American case law decisions and s.66 of Australian ICA 1984, to extend the restrictions on the insurer's subrogation rights against co-insured and insured's employee.

(a) The insurer can not exercise his right to claim indemnity by subrogation against the family members of the insured or the other members comprising such family of the insured unless the occurrence of the insured event referred to in the first paragraph of article 44 has resulted from the wilful misconduct of such a third party. 'Family members of the insured' refers to husband and wife, their parents, and children. 'Other persons comprising such family of the insured' refers to other persons except the members mentioned above, such as grandparents, grandparents in law, grandchildren, grandchildren in law,

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and art. 81 of the Contract Law of the PRC 1999 which governs the matters of the assignment of creditor's right.

[47] This amendment is suggested by referring to s.79(1) of the Marine Insurance Act 1906 (UK).

brothers, sisters and persons who are supporters for the insured or persons who are supported by the insured.[48]

(b) The insurer can not exercise the subrogation right against his insured employer's employee if the loss is caused by the employee in the course of or arose out of the employment and is not due to the employee's wilful misconduct.[49]

(c) The insurer can not exercise his subrogation right against his insured's partner or a co-insured where the loss is caused by such a third party negligently rather than by wilful misconduct. [50]

[Comparing to article 46 of the Insurance Law:
The insurer may not exercise his right to claim indemnity by subrogation against the insured's family members, or other persons comprising such family of the insured, unless the insured's family members or other persons comprising such family of the insured cause an event insured against to occur intentionally as mentioned in the first paragraph of article 44 hereof.]

(4) It is recommended that a new article should be added into the Insurance Law, in order to govern the relationship between the legal subrogation and the contractual subrogation. In this matter, the Contract Law 1999 (PRC) should be followed,[51] the Unfair Terms in Consumer Contracts Regulations 1999 (UK) and Australian and Taiwan insurance laws are recommended as a model.[52]

Where an insurance contract contains one of the following clauses, such provision is not valid: (1) a clause which immunises or diminishes the insurer's legal obligations or duties which are imposed on the insurer by this law; (2) a clause which deprives or limits the rights of the proposer, beneficiaries or insured vested by this law; (3) a clause which increases the obligations or duties of the insured;

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[48] The interpretation of the two phrases is according to Yu Xinnian. See Yu Xinnian and Gao Shengping, Zuixin Baoxianfa Tiaowen Shiyi (The Most Recent Interpretation on the Articles of the Insurance Law), p.118, People's Court Press, 1995.

[49] By referring to the English "gentleman's agreement" and the decision in *Morris v. Ford Motor Co.* and s.66 of the Australian ICA 1984.

[50] By referring to the English, Canadian and American approaches on the restriction of an insurer's subrogation right against a negligent co-insured.

[51] Art. 40.

[52] See The Unfair Terms in Consumer Contracts Regulations 1999 (UK), regulations 4, 5 and 8; Australian ICA 1984 s.52(1); and the Insurance Law of Taiwan 1998 art. 54 and 54(1).

(4) other terms or clauses which are apparently prejudicial to the rights of the proposer, beneficiaries or insured.

Accordingly, a clause which vests an insurer the right to control the subrogation proceedings before he has paid the insured shall not be valid.[53] Similarly, the operation of the immunity to the family members of the insured from an insurer's claim by the subrogation right stipulated in article 46 cannot be removed by a contrary clause in the policy.

(5) It is suggested that a rule relating to subrogation and contribution should be placed into the Chinese Insurance Law as follows:

"**An insurer who had indemnified the insured could not exercise subrogation rights by using the insured's name against another contractual indemnifier (no matter he is an insurer or not) also liable for the same loss, instead, he can seek a contribution from the another indemnifier by using his own name. In other words that the principle of contribution is not confined to cases of double insurance, but is a much broader principle arising whenever there are overlapping contractual obligations to indemnify."**[54]

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[53] See art. 19 of the Motor Vehicle Insurance Policy of Ping An Insurance Company of China.

[54] This rule has long been used in common law in Australia, see *Albion Insurance v. Government Insurance Office of NSW* (1969) 121 CLR 342; and *Borg Warner (Aust) Ltd. v. Switzerland General Insurance Co. Ltd.* (1989) 16 NSWLR. Recently this rule is adopted by some Scottish judges although it is not a settled law, see *Elf enterprise (Caledonia) Ltd v. London Bridge Engineering Ltd.* [1997] TLR 607 (Ct Sn: OH), the first instance decision was reversed on appeal under the name *Caledonia North Sea Ltd v. London Bridge Engineering Ltd.*, [2000] Lloyd's Rep. I.R. 249. See also a more recent English case *Bovis Construction Ltd and Eagle Star Insurance Co Ltd v. Commercial Union Assurance Co plc.* This case has not been reported and is forthcoming in [2001] Lloyd's Rep I.R. For detailed discussion, see Chapter five of this thesis, s. 6.3 Subrogation or Contribution – the rights of insurers.

Appendix One

THE INSURANCE LAW OF THE PEOPLE'S REPUBLIC OF CHINA[1]

(Adopted at the 14th Session of the Standing Committee of the 8th National People's Congress on 30 June 1995 and effective as of 1 Oct. 1995)

PART ONE: GENERAL PROVISIONS

Article 1: This law is formulated in order to regulate insurance activities, protect the lawful rights and interests of the parties in insurance activities, strengthen the supervision and control of the insurance industry and promote the healthy development of the insurance business.

Article 2: For the purposes of this law, the term "insurance" shall refer to a commercial insurance act whereby a proposer pays a premium to an insurer in accordance with a contract while the insurer assumes liability for payment of insurance monies for property losses as a result of the occurrence of an event specified in the contract, or when the insured dies, becomes injured or disabled, falls ill or reaches the age or time limit as specified in the contract.

Article 3: This law shall apply to parties engaged in insurance activities within the People's Republic of China.

Article 4: Parties engaged in insurance activities must abide by the laws and administrative regulations and adhere to the principles of voluntariness, honesty and good faith.

Article 5: Entities engaged in commercial insurance business must be insurance companies established in accordance with this law. No other work units or individuals may engage in commercial insurance business.

Article 6: Where legal persons and other organizations in the People's Republic of China need to take out insurance inside China, such insurance shall be proposed to an insurance company

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[1] Source: the English translation of the Insurance Law, China Law & Practice, 1 Oct. 1995, pp.16-42.

in the People's Republic of China.

Article 7: In developing their business, insurance companies shall adhere to the principle of fair competition and may not engage in unfair competition.

Article 8: The financial supervision and control department of the State Council shall be responsible for supervision and control of the insurance industry in accordance with this law.

PART TWO: INSURANCE CONTRACTS

Section One: General Provisions

Article 9: An insurance contract shall be an agreement between a proposer and an insurer on the relationship of rights and obligations in respect of insurance.

The term "proposer" shall refer to a person that concludes an insurance contract with an insurer and bears an obligation to pay a premium in accordance with an insurance contract.[2]

The term "insurer' shall refer to an insurance company that concludes an insurance contract with a proposer and assumes liability for payment of insurance monies.[3]

Article 10: An insurance contract between a proposer and an insurer shall be concluded in accordance with the principles of equality, mutual benefit, consensus and voluntariness and may not harm the public interest.

No insurance companies or other work units may force a third party to conclude an insurance contract, unless insurance is required by laws or administrative regulations.

Article 11: A proposer shall have an insurable interest in the insured subject matter.[4]

An insurance contract shall be void where the proposer has no insurable interest in the insured

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[2] For the detailed discussion on this article see p. 62
[3] *Ibid.*
[4] For the detailed discussion on this article see p.60.

subject matter.[5]

The term "insurable interest" shall refer to a legally recognised interest of the proposer in the subject matter of insurance.[6]

The term "insured subject matter" shall refer to property and its related interests or the life or physical body of a person, as an object of insurance.[7]

Article 12: An insurance contract shall be formed after a proposer has made an insurance offer and an insurer has agreed to accept such offer, with an agreement on the terms and conditions of the contract reached. The insurer shall issue a policy or other insurance certificate to the proposer in a timely manner and specify the contents of the contract as agreed between the parties in the policy or other insurance certificate.

If agreed upon by the proposer and the insurer following consultations, an insurance contract may be concluded in the form of a written agreement other than that specified in the preceding paragraph.

Article 13: a proposer shall pay a premium to an insurer upon formation of an insurance contract as agreed. The insurer shall begin to assume insurance liability from the time as agreed.

Article 14: Upon formation of an insurance contract, a proposer may rescind such contract, except otherwise provided by this Law or such contract.

Article 15: Upon formation of an insurance contract, an insurer may not rescind such contract, except otherwise provided by this Law or such contract.

Article 16: When concluding an insurance contract, an insurer shall explain the details of the terms and conditions of such a contract to the proposer and may raise questions concerning relevant details of the insured subject matter, or of the insured. The proposer shall truthfully

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[5] See pp. 96-97, 125-128, 129-131 and 152-155.
[6] *Ibid.*
[7] For the detailed examination on this article see pp. 112-113.

disclose such details to the insurer.[8]

The insurer shall have the right to rescind the insurance contract where the proposer withholds facts at ill will[9] and fails to perform his duty of disclosure and truthful representation of information to the insurer or fails to perform such duty as a result of a mistake so that the failure of disclose or representation shall sufficiently influence the insurer's decision on whether he will accept the insurance or raise the premium rate.[10]

Where the proposer fails to perform his duty of disclosure and truthful representation of information to the insurer at ill will,[11] the insurer shall not be liable for payment of insurance monies in connection with events insured against that occur prior to the rescission of the contract, and shall not refund the premium.[12]

Where the failure of the proposer to perform his duty of disclosure and truthful representation as a result of a mistake has a serious impact on the occurrence of events insured against, the insurer shall not be liable for payment of insurance monies in connection with events insured against that occur prior to the rescission of the contract, but he may refund the premium.[13]

The term "events insured against" shall refer to events within the scope of insurance liability specified in an insurance contract.

Article 17: Where an insurance contract contains terms and conditions concerning exclusion of the liability of an insurer, the insurer shall clearly explain such terms and conditions to the proposer at the time of concluding the contract. Where such terms and conditions are not clearly explained, they shall not be effective.[14]

Article 18: An insurance contract shall contain the following particulars:

(1) the name and domicile of the insurer;

(2) the name and domicile of the proposer and the insured and in the case of a personal

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[8] For the detailed discussion on this article see pp. 169-174, 211-213 and 242-249.
[9] See note 25 of Chapter four.
[10] See pp. 169-174 and 184 -187.
[11] See note 25 of Chapter four.
[12] See pp. 169-174 and 199-204.
[13] See *Ibid.*
[14] See p. 242-249.

insurance contract, the name and domicile of the beneficiary;

(3) the insured subject matter;

(4) the insurance liability and exclusion of liability;

(5) the insurance period and time of commencement of insurance liability;

(6) the insured value;

(7) the insured sum;

(8) the premium and the method of payment thereof;

(9) the insurance money or method of payment;

(10) liability for breach of contract and settlement of disputes; and

(11) the date of concluding the contract.

Article 19: A proposer and an insurer may agree on other particulars concerning insurance in an insurance contract, in addition to those particulars provided for in the preceding Article.

Article 20: During the term of an insurance contract, the proposer and insurer may amend relevant contents of such contract after reaching an agreement through consultations.

Where the insurance contract is amended, the insurer shall endorse or attach an endorsement to the original policy or other insurance document, or a written agreement on the amendments shall be concluded between the proposer and the insurer.

Article 21: Proposers, the insured or beneficiaries shall immediately notify insurers after learning of the occurrence of an event insured against.

The term "insured" shall refer to a person whose property or physical body is covered by an insurance contract and who has the right to claim insurance monies. Proposers may be the insured.[15]

The term "beneficiary" shall refer to a person with the right to claim insurance monies, as designated in a personal insurance contract by the insured or the proposer. Proposers and the insured may be beneficiaries.[16]

Article 22: When insurance monies are claimed from an insurer in accordance with an

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[15] See p.62.
[16] See p. 62.

insurance contract following the occurrence of an event insured against, the proposer, the insured or the beneficiary shall provide documents and information confirming the nature and cause of such event, the degree of loss, etc. as he can provide.

Where the insurer considers relevant documents and information incomplete pursuant to the provisions of the insurance contract, he shall notify the proposer, the insured or the beneficiary of providing the missing relevant documents and information.

Article 23: Upon receipt of a claim for insurance monies from the insured or the beneficiary, the insurer shall verify the claim in a timely manner. Where the claim comes under his insurance liability, he shall perform his obligation to pay insurance monies within 10 days of reaching an agreement with the insured or the beneficiary on the sum insured. Where the sum insured and the time limit for payment thereof are stipulated in the insurance contract, the insurer shall perform his obligation to pay insurance monies in accordance with such stipulations.

Where the insurer fails to perform his obligations as specified in the preceding paragraph in a timely manner, he shall indemnify the insured or the beneficiary for the losses suffered as a result thereof, in addition to payment of the insurance monies.

No work units or individuals may unlawfully interfere with the insurer's performance of his obligation to pay insurance monies or restrict the insured's or the beneficiary's right to obtain insurance monies.

The term "sum insured" shall refer to the maximum amount of insurance monies for which an insurer assumes indemnity or payment liability.

Article 24: Where a claim for insurance monies received by an insurer from an insured or a beneficiary does not come under his insurance liability, the insurer shall issue a written notice of refusal of payment of insurance monies.

Article 25: Where an insurer is unable to determine the amount of insurance monies within 60 days of receiving a claim for insurance monies, relevant documents and information, he shall first pay the minimum amount as can be determined on the basis of the existing documents and information. After determining the final amount of insurance monies, the insurer shall make up

the difference in respect of such insurance monies.

Article 26: The right of the insured or the beneficiary to claim insurance monies from the insurer under insurance other than life insurance shall be extinguished if it is not exercised within two years from the date on which the insured or the beneficiary learned of the occurrence of the event insured against.

The right of the insured or the beneficiary to claim insurance monies from the insurer under life insurance shall be extinguished if it is not exercised within five years from the date on which the insured or the beneficiary learned of the occurrence of the event insured against.

Article 27: Where the insured or the beneficiary falsely claims that an event insured against has occurred before such event actually occurs, and submits a claim for payment of insurance monies to the insurer, the insurer shall have the right to rescind the insurance contract without having to refund the premium.

Where the proposer, the insured or the beneficiary creates an event insured against at ill will, the insurer shall have the right to rescind the insurance contract and shall not be liable for payment of insurance monies and shall not refund the premium, except otherwise provided for in the first paragraph of Article 64 hereof.

Where the proposer, the insured or the beneficiary fabricates false causes of an event or overstates the degree of losses by means of forged or altered relevant documents, information or other evidence after the occurrence of such event, the insurer shall not be liable for payment of insurance monies for the portion that is false.

The proposer, the insured or the beneficiary shall return the insurance monies or reimburse the expenses paid by the insurer as a result of any of the acts in the preceding three paragraphs performed by the said proposer, insured or beneficiary.

Article 28: Where an insurer transfers part of his undertaken insurance business to another insurer by means of underwriting, such insurance shall be reinsurance.

At the request of the re-insurer, the original insurer shall disclose to the re-insurer relevant

details of his own liability and the original insurance.

Article 29: The re-insurer may not demand payment of the premium from the original proposer.

The original insured or the original beneficiary may not submit a claim for insurance monies to the re-insurer.

The origianl insurer may not refuse to perform or delay the performance of his original insurance liability on the grounds of the failure of the re-insurer to perform his reinsurance liability.

Article 30: When a dispute arises between the insurer and the proposer, the insured or the beneficiary over the terms and conditions of an insurance contract, the People's Court or arbitration organization shall interpret such terms and conditions in favour of the insured and the beneficiary.

Article 31 An insurer or a re-insurer is obliged to maintain the confidentiality of the business and details of the property of the proposer, the insured or the original insurer that he learns of in the course of handling the insurance.

Section Two: Property Insurance Contracts

Article 32: Property insurance contracts shall be insurance contracts in which property and its related interests shall be the subject matter of insurance.

In this Section, the term "property insurance contract" is abbreviated to "contract", unless expressly stated otherwise.

Article 33: The insurer shall be notified of the assignment of the subject matter of insurance, and after the insurer agrees to continue to underwrite the insurance, the contract shall be amended according to law, except in the case of contracts for insurance of the transport of goods and contracts that provide otherwise.

Article 34: After the commencement of insurance liability for a contract for insurance of the transport of goods or the journey taken by a means of transportation, the parties to the contract may not rescind such contract.

Article 35: The insured shall abide by State regulations such as those concerning fire protection, safety, production operations and labour protection, etc., and shall maintain the safety of the subject matter of insurance.

As agreed in the contracts, the insurer may inspect the safety of the subject matter of insurance and submit a written proposal to the proposer or the insured to remove unsafe factors and potential dangers.

Where the proposer and the insured fail to perform their due responsibilities for the safety of the subject matter of insurance as agreed, the insurer shall have the right to demand an increase in the premium or to rescind the contract.

Upon consent of the insured, the insurer may adopt preventive or safety measures to maintain the safety of the subject matter of insurance.

Article 36: Where the degree of risk of the subject matter of insurance increases during the term of a contract, the insured shall notify the insurer in a timely manner in accordance with the contract and the insurer shall have the right to demand an increase in the premium or rescind the contract.[17]

Where the insured fails to perform his obligation of notification specified in the preceding paragraph, the insurer shall not be liable for indemnity in the case of the occurrence of an event insured against due to the increase in the degree of risk.

Article 37: Unless a contract provides otherwise, the insurer shall reduce the premium and refund the corresponding premium calculated on a daily basis under any of the following circumstances:

(1) the degree of risk of the subject matter of insurance has decreased remarkably as a result of the changes to the circumstances under which the premium rate was determined: or

(2) the value of the subject matter of insurance has decreased remarkably.

Article 38: Where a proposer demands rescission of a contract prior to the commencement of insurance liability, he shall pay a service charge to the insurer and the insurer shall refund the premium. Where the proposer demands rescission of the contract after the commencement of insurance liability, the insurer may charge the premium for the period from the date of commencement of insurance liability to the date of rescission of the contract, with the balance to be refunded to the proposer.

Article 39: The insured value of the subject matter of insurance may be agreed upon by the proposer and the insurer and be specified in the contract. Alternatively, such value may be determined on the basis of the actual value of the subject matter of insurance at the time of the occurrence of an event insured against.

The sum insured may not exceed the insured value, where the sum insured exceeds the insured value, the portion exceeding the insured value shall be void.

Where the sum insured is less than the insured value, the insurer shall assume indemnity liability in accordance with the proportion of the sum insured to the insured value, unless the contract provides otherwise.

Article 40: Where a proposer takes out double insurance, he shall notify each insurer of the relevant details of such double insurance.

Where the total of the sums insured under double insurance exceeds the insured value, the total amount of indemnity of each insurer may not exceed the insured value. Each insurer shall assume indemnity liability according to the ratio of his sum insured to the total of the sums insured, unless the contract provides otherwise.

The term "double insurance" shall refer to insurance for which the proposer concludes separate insurance contracts with two insurers or more in respect of the same subject matter of insurance, the same insurable interest and the same event(s) insured against.

Article 41: On the occurrence of an event insured against, the insured shall be responsible for

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[17] See pp. 222-226.

making the best efforts to adopt the necessary measures to prevent or reduce losses.

The necessary and reasonable expenses paid by the insured after the occurrence of an event insured against in order to prevent or reduce losses in respect of the subject matter of insurance shall be borne by the insurer. The amount of such expenses borne by the insurer shall be calculated separately from the indemnity for the losses in respect of the subject matter of insurance, and the amount of the expenses shall not exceed the sum insured.

Article 42: Where a partial loss is suffered in respect of the subject matter of insurance, the proposer may terminate the contract within 30 days after the insurer has indemnified the proposer for such loss. The insurer may also terminate the contract, except that the contract stipulates that he may not do so. Where the insurer terminates the contract, he shall notify the proposer 15 days in advance and shall refund to the proposer the premium for the portion of the subject matter of insurance in respect of which no loss was suffered, less the portion chargeable from the date of commencement of insurance liability until the date of termination of the contract.

Article 43: Where the sum insured has already been paid in full by the insurer and such sum is equal to the insured value following the occurrence of an event insured against, all rights to the subject matter of insurance in respect of which loss was suffered shall be owned by the insurer.

Where the sum insured is less than the insured value, the insurer shall take over part of the rights to the subject matter of insurance in respect of which loss was suffered, according to the ratio of the sum insured to the insured value.[18]

Article 44: Where a third party damages the subject matter of insurance, thereby leading to the occurrence of an event insured against, the insurer shall, from the date of payment of insurance monies to the insured, be subrogated to the insured's right to claim indemnity from a third party within the amount of indemnity.[19]

Where the insured has already obtained indemnity from a third party following the occurrence of an event insured against as mentioned in the preceding paragraph, the insurer may, at the time of paying the insurance monies, deduct an amount equivalent to such indemnity obtained

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[18] See pp. 330-334.
[19] See pp. 271-278 and 294 -299.

by the insured from the third party.[20]

The insurer's exercise of his right of claim by subrogation in accordance with the first paragraph shall have no impact on the insured's right to claim indemnity from the third party for the portion which has not been indemnified.[21]

Article 45: Where the insured waives his right to claim indemnity from a third party following the occurrence of an event insured against and prior to the insurer's payment of insurance monies, the insurer shall not be liable for the payment of insurance monies.[22]

Where the insured, without the consent of the insurer, waives his right to claim indemnity from a third party after the insurer has paid insurance monies to him, the waiver shall be void.[23]

Where the insurer is unable to exercise his right to claim indemnity by subrogation due to the fault of the insured, the insurer may make a corresponding deduction from the amount of indemnity.[24]

Article 46: The insurer may not exercise his right to claim indemnity by subrogation against the insured's family members, or other persons comprising such family of the insured, unless the insured's family members or other persons comprising such family of the insured cause an event insured against to occur intentionally as mentioned in the first paragraph of Article 44 hereof.[25]

Article 47: When the insurer exercises his right to claim indemnity by subrogation against a third party , the insured shall provide the insurer with the necessary documents and relevant details known to him.

Article 48: The necessary and reasonable expenses paid by the insurer or the insured in order to investigate and establish the nature and cause of the event insured against and the degree of loss in respect of the subject matter of insurance shall be borne by the insurer.

Article 49: In respect of damages caused to a third party by the insured under liability insurance,

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[20] See pp. 271-278.
[21] See pp. 271-278 and 294-299.
[22] See pp. 323-325.
[23] *Ibid.*
[24] *Ibid.*

the insurer may directly pay insurance monies to such third party, as provided for by law or in the contract.

The term " liability insurance" shall refer to insurance where the subject matter is the insured's legal liability to indemnify a third party.

Article 50: Where arbitration or legal proceedings are instituted against the insured under liability insurance as a result of damages caused to a third party by an event insured against, the arbitration or court costs and other necessary and reasonable expenses paid by the insured shall be borne by the insurer, unless the contract provides otherwise.

Section Three: Personal Insurance Contracts

Article 51: The term "personal insurance contract" shall refer to an insurance contract the subject matter of which is the life or physical body of a person.

In this Section, the term "personal insurance contract" shall be abbreviated to "contract", unless expressly stated otherwise.

Article 52: A proposer shall have an insurable interest in the following persons:

(1) himself;
(2) his spouse, children and parents; and
(3) members of his family and close relatives other than those mentioned in the preceding item who are in the relationships of fostering or raising or supporting with him.[26]

In addition to the persons mentioned in the preceding paragraph, the proposer shall be deemed to have an insurable interest in any insured person who agrees with the proposer to conclude a contract on his life.[27]

Article 53: Where the age of the insured as declared by the proposer is not true and his true age fails to meet the age requirements set forth in the contract, the insurer may rescind the contract

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[25] See pp. 306-311.
[26] See pp. 70-77.
[27] See pp. 84-86 and 96- 99.

and in this case, he shall refund the premium to the proposer after deducting a service charge, except that more than two years have lapsed from the date of conclusion of the contract.

Where the age declared by the insured is not true so that the proposer pays a premium less than the premium payable, the insurer shall have the right to adjust the premium and demand the proposer to make up the premium, or pay insurance monies in accordance with the proportion of the premium actually paid to the premium payable at the time of paying such insurance monies.

Where the age declared by the insured is untrue so that the proposer has actually paid a premium more than the premium payable, the insurer shall return the exceeding premium received to the proposer.

Article 54: A proposer may neither propose nor an insurer may underwrite personal insurance for a person without capacity for civil acts where the death of such a person whose life is insured is set as the condition for payment of the sum insured.[28]

Proposals of personal insurance by parents for their minor children shall not be governed by the preceding paragraph, provided that the total sum insured payable upon the death of minor children whose lives are insured does not exceed the limit set by the financial supervision and control departments.[29]

Article 55: A contract in which the death of a person whose life is insured is set as the condition for payment of the insurance monies shall be void where such contract has not been agreed by and the sum insured has not been approved by the insured in writing.[30]

Policies issued for contracts in which the death of a person whose life is insured is set as the condition for payment of the insurance monies may not be assigned or pledged without the written consent of the insured.

Proposals of personal insurance by parents for their minor children shall not be governed by the first paragraph.

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[28] See pp. 108.
[29] See pp. 72-74.
[30] See pp. 96-99.

Article 56: Following conclusion of a contract, the proposer may pay the entire premium in a lump sum to the insurer or pay the premium by instalments as specified in the contract.

Where the contract provides for payment of the premium by instalments, the proposer shall pay the first instalment promptly upon conclusion of such contract and pay the remaining instalments according to schedule.

Article 57: Where the contract provides for payment of the premium by instalments and the proposer, after having paid the first instalment of the premium, fails to pay the second instalment within 60 days upon the expiration of the time limit therefore the effect of the contract shall be suspended or the sum insured shall be reduced by the insurer as agreed in the contract, except as otherwise provided for in the contract.

Article 58: Where the effect of a contract is suspended pursuant to the preceding Article, such effect shall be restored after the insured and the proposer have reached an agreement through consultations, and the proposer has made up the unpaid premium. However, where the parties fail to reach an agreement within two years from the date of suspension of such effect, the insurer shall have the right to rescind the contract.

Where the insurer rescinds a contract pursuant to the preceding paragraph and the proposer has been paying premium for two years or more, the insurer shall refund the cash value of the policy in accordance with the contract. Where the proposer has been paying premium for less than two years, the insurer shall refund the premium after deducting a service charge.

Article 59: An insurer may not require a proposer to pay a premium for personal insurance by means of litigation.

Article 60: The beneficiary of personal insurance shall be designated by the insured or the proposer.

The consent of the insured shall be required when the proposer designates a beneficiary.[31]

When the insured is a person without capacity for civil acts or with limited capacity for civil

acts, the beneficiary may be designated by his guardian.[32]

Article 61: The insured or the proposer may designate one or several persons as beneficiaries.

Where there are several beneficiaries, the insured or the proposer may determine the sequence in which they shall receive benefits and the amount of benefits. Where the amount of benefits is not determined, the beneficiaries shall be entitled to equal amount of the benefits.[33]

Article 62: The life insured or the proposer may change the beneficiary and in this case, he shall notify the insurer in writing. Upon receipt of a written notice of a change of beneficiary, the insurer shall endorse the policy.[34]

A change of the beneficiary made by the proposer shall be subject to the consent of the insurer.[35]

Article 63: Upon the death of the life insured, the insurance monies shall become part of the life insured's estate, and the insurer's obligation to pay insurance monies shall be performed in favour of the life insured's successors under any of the following circumstances:

(1) where no beneficiary has been designated;

(2) where there is only one beneficiary, and such beneficiary dies prior to the death of the insured; or

(3) where there is only one beneficiary, and such beneficiary loses or waives his beneficiary right according to law.[36]

Article 64: The insurer shall not be liable for payment of insurance monies where the proposer or a beneficiary causes the insured to die, become disable, injured or sick at ill will.[37] Where the proposer has been paying premium for two years or more, the insurer shall refund the cash value of the policy to the other entitled beneficiaries as provided for in the contract.

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[31] See pp. 72-74 and 93-94.
[32] See p. 74.
[33] See pp. 87-93.
[34] *Ibid.*
[35] *Ibid.*
[36] See pp. 87-93.
[37] See p. 174, note 24.

A beneficiary shall lose his beneficiary right where he causes the insured to die or become disable or injured at ill will, or intends to kill the insured but fails.

Article 65: In the case of contracts in which the death of a person whose life is insured is set as the condition for payment of the insurance monies, the insurer shall not be liable for payment of insurance monies where the insured commits suicide, except as provided for in the second paragraph hereof. However, the insurer shall refund the cash value of the policy in accordance with the policy in respect of premiums already paid by the proposer.

In the case of a contract in which the death of a person whose life is insured is set as the condition for payment of the insurance monies, the insurer may pay insurance monies in accordance with the contract if the insured commits suicide after two years from the date of conclusion of the contract.

Article 66: The insurer shall not be liable for payment of insurance monies where the insured commits a crime at ill will causing injury, disability or death to himself. Where the proposer has been paying premium for two years or more, the insurer shall refund the cash value of the policy.

Article 67: Where the insured covered by personal insurance comes across an event insured against, such as death, injury, disability or illness, etc., as a result of an act on the part of a third party, the insurer shall not have recourse against such third party after the insurer has paid insurance monies to the insured or the beneficiary.

Article 68: Where the proposer rescinds a contract and has been paying premium for two years or more, the insurer shall refund the cash value of the policy within 30 days of receiving the notice of rescission of the contract. Where the insured has been paying premium for less than two years, the insurer shall refund the premium in accordance with the contract after deducting a service charge.

PART THREE: INSURANCE COMPANIES

Article 69: Insurance companies shall be organized in one of the following forms:

(1) company limited by shares; or

(2) wholly State-owned company.

Article 70: The establishment of an insurance company must be approved by the financial supervision and control department.

Article 71: The following requirements shall be met for establishing an insurance company:

(1) possession of the articles of association that conform to this Law and the Company Law;

(2) possession of the minimum amount of registered capital prescribed herein;

(3) possession of senior management personnel with the professional knowledge of their positions and with working experience in the business;

(4) possession of a sound organizational structure and management system; and

(5) possession of a business site that meet the requirements, and other business-related facilities.

The financial supervision and control department shall take into consideration the needs for the development and fair competition of the insurance industry when examining an application for approval to establish insurance companies.

Article 72: The minimum amount of registered capital of an insurance company to be established shall be Rmb 200 million.

The minimum amount of registered capital of an insurance company must be paid-up capital in currency.

The financial supervision and control department may adjust the minimum amount of registered capital of an insurance company according to the scope and scale of its business. However, such amount may not be less than the minimum amount set forth in the first paragraph.

Article 73: The following documents and information shall be submitted for establishing an insurance company:

(1) a written application for approval to establish the insurance company, stating the name,

amount of registered capital, scope of business, etc., of such company:

(2) a feasibility study report; and

(3) other documents and information specified by financial supervision and control department.

Article 74: After an application for approval to establish an insurance company gone through preliminary examination, the applicant shall make preparations for the establishment of the insurance company in accordance with the provisions hereof and of the Company Law. Where the requirements for establishing an insurance company specified in Article 71 hereof are met, an official application form and relevant documents and information listed below shall be submitted to the financial supervision and control department:

(1) the articles of association of the insurance company;

(2) the register of shareholders and shareholding owned by such shareholders, or the register of contributors and the amounts of their contributions;

(3) proof of creditworthiness and relevant information of the shareholders holding ten percent or more of the shares;

(4) capital verification certificates issued by the statutory capital verification authority;

(5) resumes and qualification certificates of the senior management personnel who are to hold positions;

(6) business policies and plans;

(7) information on the business site and other business-related facilities; and

(8) other documents and information specified by the financial supervision and control department.

Article 75: The financial supervision and control department shall decide whether to grant or to refuse approval within six months of receiving an official application documents for approval to establish an insurance company.

Article 76: The approval authority shall issue a "Permit for Insurance Business Operations" to an insurance company approved to be established. Such insurance company shall then handle registration procedures with, and obtain a business license from, the administration for industry and commerce on the strength of such permit.

Article 77: Where an insurance company fails to handle company establishment registration

without proper reason within six months of obtaining a "Permit for Insurance Business Operations", its "Permit for Insurance Business Operations" shall automatically become void.

Article 78: Upon establishment, an insurance company shall allocate 20 percent of the total amount of its registered capital as security, and deposit such security with a bank designated by the financial supervision and control department, and may not use it other than for paying the debts of the insurance company at the time of liquidation.

Article 79: The establishment by an insurance company of a branch office inside or outside the People's Republic of China shall be subject to the approval of the financial supervision and control department for the acquisition of a "Permit for Insurance Business Operations of a Branch Office".

The branch offices of an insurance company shall not have the status of a legal person, with their civil liability to be borne by the insurance company.

Article 80: The establishment by an insurance company of a representative office inside or outside the People's Republic of China shall be subject to the approval of the financial supervision and control department.

Article 81: Any of the following changes in respect of an insurance company must be approved by the financial supervision and control department:

(1) change of the name;
(2) change in the registered capital;
(3) change of the business site of the company or the branch office;
(4) adjustment of the scope of business;
(5) division or merger of the company;
(6) amendment to the company's articles of association;
(7) change of capital contributors or shareholders holding ten percent or more of the company's shares; or
(8) other changes specified by the financial supervision and control department.

Where an insurance company changes a director or the general manager, it shall submit to the

financial supervision and control department for examination of his qualifications for the position.

Article 82: The provisions of the Company Law shall apply to the organizational structure of insurance companies.

Article 83: Wholly State-owned insurance companies shall set up a board of governors. A board of governors shall be composed of the personnel from the financial supervision and control department, relevant experts and representatives of the personnel working in the insurance company. The board of governors shall supervise the withdrawal of reserves, the minimum repayment capability as well as the preservation and appreciation of the value of State-owned assets, etc., of the wholly State-owned insurance company, and also supervise the senior management personnel of the company to see whether they carry out activities in violation of laws, administrative regulations or the articles of association, or whether such activities are harmful to the company's interest.

Article 84: Where an insurance company is divided or merged, or where a cause for dissolution of the company as specified in its articles of association arises, it shall be dissolved upon approval by the financial supervision and control department. The insurance company shall set up a liquidation committee according to law for carrying out liquidation.

Insurance companies with life insurance business may not be dissolved, but they may be divided or merged.

Article 85: Where the "Permit for Insurance Business Operations" of an insurance company is legally revoked by the financial supervision and control department due to the company's violation of laws or administrative regulations, the company shall be liquidated according to law. The financial supervision and control department shall promptly organize a liquidation committee according to law for carrying out liquidation.

Article 86: Insurance companies that cannot pay debts upon maturity shall be lawfully declared bankrupt by a People's Court after the financial supervision and control department has given its approval. Where an insurance company is declared bankrupt, the People's Court shall organize relevant work unit such as the financial supervision and control department, etc., and relevant

individuals to set up a liquidation committee for carrying out liquidation.

Article 87: Where insurance company with life insurance business is closed down or declared bankrupt according to law, its life insurance contracts and reserves must be transferred to another insurance company with life insurance business. Where no transfer agreement can be reached with another insurance company, the financial supervision and control department shall designate an insurance company with life insurance business to take over such contracts and reserves.

Article 88: Where an insurance company goes into bankruptcy according to law, the property involved in the bankruptcy shall be applied to repayment purposes in the following chronological order after being used first for repayment of expenses involved in the bankruptcy:

(1) wages and labour insurance premiums owned to staff and workers;
(2) payment of insurance monies;
(3) taxes owned; and
(4) payment of company's debts;

Where the property involved in the bankruptcy is insufficient to pay all the claims in the chronological order it shall be distributed on a pro-rate basis.

Article 89: Insurance companies which terminate their business activities according to law shall have the "Permits for Insurance Business Operations" cancelled.

Article 90: Matters concerning the establishment, dissolution and liquidation of, and changes in respect of, insurance companies that are not provided for herein shall be governed by the Company Law and other relevant laws or administrative regulations.

PART FOUR: INSURANCE BUSINESS RULES

Article 91: The scope of business of insurance company:

(1) property insurance business which include insurance business such as loss of property

insurance, liability insurance, credit insurance, etc.; or

(2) personal insurance business which include insurance business such as life insurance, health insurance, accident insurance, etc.

An insurer may not at the same time engage in both property insurance and personal insurance business.

The scope of business of an insurance company shall be approved by the financial supervision and control department. An insurance company may only engage in the insurance business activities within the approved scope of business.

The State Council shall formulate measures for division of business in accordance with the second paragraph in respect of insurance companies established prior to the implementation of this Law.

Article 92: Insurance companies may, upon approval by the financial supervision and control department, engage in the following reinsurance business in respect of the insurance business mentioned in the preceding article:

(1) taking out of an insurance to another insurer;

(2) acceptance of an insurance from another reinsurer.

Article 93: Insurance companies which engage in insurance business other than life insurance shall make allocations from their retained insurance premiums of the current year to a portfolio reserve. An amount of 50 percent of the retained insurance premiums of the current year shall be allocated and carried over.

Insurance companies which engage in life insurance business shall make allocations to a portfolio reserve on the basis of the whole net value of their effective life insurance policies.

Article 94: Insurance companies shall make allocations to an outstanding loss reserve on the basis of the amount of insurance monies already claimed and the amount of insurance monies not yet claimed in respect of events insured against that have already occurred.

Article 95: In addition to making allocations to reserves in accordance with the two preceding articles, insurance companies shall make allocations to a common reserve in accordance with the provisions of the relevant laws, administrative regulations and State financial and accounting system.

Article 96: In order to safeguard the interest of the insured and support the stable and sound operation of insurance companies, insurance companies shall deposit allocations into an insurance protection fund as prescribed by the financial supervision and control department.

The insurance protection fund shall be centrally managed and used in unified manner.

Article 97: An insurance company shall possess the minimum solvency corresponding to its scale of business. The balance of the actual assets of an insurance company less its actual liabilities may not be lower than the amount prescribed by the financial supervision and control department. Where such balance is lower than the prescribed amount, capital shall be increased to make up the difference.

Article 98: Premium of the current year retained by insurance companies engaged in property insurance business may not be more than four times the sum of the paid-up capital and common reserve of such insurance companies.

Article 99: The liability of an insurance company for each risk, that is, the maximum coverage of loss that may be caused by an event insured against, may not be more than ten percent of the sum of paid-up capital and common reserve of such insurance company. Any part exceeding the sum shall be reinsured.

Article 100: Insurance companies shall submit their methods for the assessment of risks and their arrangement plans for catastrophic risks to the financial supervision and control department for approval.

Article 101: Insurance companies shall, in accordance with the relevant State regulations, reinsure 20 percent of each insurance that they accept, except for life insurance.

Article 102: Where an insurance company needs to reinsure its own insurance business, it shall

give priority to insurance companies inside the People's Republic of China for reinsurance.

Article 103: The financial supervision and control department shall have the right to restrict or prohibit insurance companies from reinsuring their own insurance business to insurance companies outside the People's Republic of China, or from accepting reinsurance business from insurance companies outside the People's Republic of China.

Article 104: Insurance companies must employ funds in a stable and safe manner, and ensure the preservation and appreciation of asset value.

The employment of funds by insurance companies shall be limited to bank deposits, purchase and sale of government bonds and financial bonds, and other ways specified by the State Council.

The funds of insurance companies may not be used for the establishment of securities houses or investment in enterprises.

The funds applied by an insurance company and the specific percentage of funds for its specific projects out of its total assets shall be determined by the financial supervision and control department.

Article 105: An insurance company and its working personnel may not perform the following acts in the course of insurance business operations:

(1) deceiving proposer, the insured or the beneficiary;
(2) withholding important details relating to an insurance contract from the proposer;
(3) hindering the proposer from performing, or inducing the proposer not to perform, his duty of disclosing the true details as specified herein; and
(4) promising the proposer, the insured or the beneficiary a rebate on the insurance premium or other benefits not provided for in the insurance contract.

PART FIVE: SUPERVISION AND ADMINISTRATION OF THE INSURANCE INDUSTRY

Article 106: The basic insurance clauses and premium rates for the main types of risk in commercial insurance shall be formulated by the financial supervision and control department.

The insurance clauses and premium rates for other types of risk proposed by insurance companies shall be submitted to the financial supervision and control department for the record.

Article 107: The financial supervision and control department shall have the right to inspect the business situation, financial position and employment of funds by insurance companies, and require insurance companies to provide relevant written reports and information within a prescribed term.

Insurance companies shall be subject to supervision and inspection in accordance with laws.

Article 108: Where an insurance company fails to allocate or carry over funds to various reserves or handle reinsurance in accordance with the provisions hereof, or materially violates the provisions hereof relating to the employment of funds, the financial supervision and control department shall order such insurance company to rectify the situation within a specified term by adopting the following measures:

(1) allocating or carrying over the funds to various reserves according to law;
(2) handling reinsurance according to law;
(3) rectifying illegal employment of funds; and
(4) replacing responsible persons and relevant management personnel.

Article 109: Where an insurance company fails to rectify the situation within the specified term after the financial supervision and control department has made a decision on rectification within a specified term in accordance with the preceding paragraph, the financial supervision and control department shall decide to appoint insurance professionals and designate relevant personnel of the insurance company to form an organization for restructuring the insurance company.

The name of the insurance company to be restructured, reasons for restructuring, restructuring organization and term for restructuring shall be stated in the decision on the restructuring and

shall be publicly announced.

Article 110: During the restructuring process, the restructuring organization shall have the right to supervise the day-to-day business of an insurance company. The responsible persons and relevant management personnel of such company shall exercise their own functions and powers under the supervision of the restructuring organization.

Article 111: During the restructuring process, the original business of an insurance company shall be continued; however, the financial supervision and control department shall have the right to stop new business development or part of the business, or to change the employment of funds.

Article 112: Where an insurance company being restructured resumes to a normal business situation following correction of its acts that were in violation of the provisions hereof, the restructuring organization shall issued a report and the restructuring shall be ended after approval from the financial supervision and control department.

Article 113: Where an insurance company violates the provisions hereof by damaging public interest so that the solvency of the insurance company may or may have been seriously endangered, the financial supervision and control department may assume control over such company.

The purpose of assumption of control shall be to take necessary measures for an insurance company over which control is assumed for the protection of the interests of the insured and the resumption of normal business by such insurance company. The credit and liabilities of an insurance company over which control is assumed shall remain unchanged as a result of such assumption of control.

Article 114: The composition of the organization assuming control and the method of assuming control shall be decided by the financial supervision and control department, and be publicly announced.

Article 115: The financial supervision and control department may decide to extend the term of control upon expiration of such term. However, the maximum term of control may not be

longer than two years.

Article 116: Where an insurance company over which control was assumed has recovered its capacity for normal operations upon expiration of the term of control, the financial supervision and control department may decide to terminate control.

Where the organization assuming control regards the property of the insurance company placed under control as insufficient for the full repayment of its debts, it may, upon approval by the financial supervision and control department, lawfully apply to a People's Court for declaration of bankruptcy of such insurance company.

Article 117: Within three months after the end of each fiscal year, an insurance company shall submit to the financial supervision and control department a business report, financial and accounting reports and relevant statements for the preceding year, and publish the same according to law.

Article 118: By the end of each month, an insurance company shall submit to the financial supervision and control department business statistical statements for the preceding month.

Article 119 Insurance companies engaged in personal insurance business must employ actuarial professionals recognized by the financial supervision and control department and set up an actuarial reporting system.

Article 120: The insurer and the insured may employ an independent evaluation organization established according to law or experts with statutory qualifications to carry out evaluation and appraisal of events insured against.

Article 121: Insurance companies shall properly keep a complete set of account books, the original vouchers and information concerning their business activities.

The term for keeping a complete set of account books, original vouchers and relevant information mentioned in the preceding paragraph shall begin from the date of termination of an insurance contract, and may not be less than ten years.

PART SIX: INSURANCE AGENTS AND INSURANCE BROKERS

Article 122: Insurance agents shall be work units or individuals entrusted by an insurer to handle insurance business on behalf of the insurer within the scope of the insurer's authorization and shall charge an agency fee to the insurer.

Article 123: Insurance brokers shall be work units that provide intermediary services for the conclusion of insurance contracts between proposers and insurers in the interests of the proposers, and shall charge a commission therefore according to law.

Article 124: An insurer shall be responsible for the acts of its insurance agents in handling insurance business on its behalf in line with its authorization.

Insurance agents engaged in life insurance agency business may not accept entrustment by two or more insurers at the same time.

Article 125: Insurance brokers shall be liable for compensation of loss suffered by the proposer or the insured due to the fault of such insurance brokers in the course of handling insurance business.

Article 126: When handling insurance business, insurance agents and insurance brokers may not coerce or induce proposers to conclude, or to restrict proposers in concluding, an insurance contract by taking advantage of their administrative powers and functions, the convenience provided by their positions or other unfair means.

Article 127: Insurance agents and insurance brokers shall meet the qualification requirements specified by the financial supervision and control department, obtain a "Permit for Insurance Agency Business Operations" or a "Brokerage Permit", register with the administration for industry and commerce, obtain a business license and pay a deposit or take out professional liability insurance.

Article 128: Insurance agents and insurance brokers shall have their own business sites, special account books for recording the particulars of revenue and expenditure relating to insurance

agency or brokerage business, and shall be subject to supervision of the financial supervision and control department.

Article 129: Insurance companies shall keep a register of their insurance agents.

Article 130: The provisions of Articles 105, 107 and 117 hereof shall apply to insurance agents and insurance brokers.

PART SEVEN: LEGAL LIABILITY

Article 131: Where a proposer, an insured or a beneficiary engages in insurance fraud by committing any of the following acts, and a criminal offense is constituted, his criminal liability shall be pursued according to law:

(1) the proposer takes out insurance for a fictitious subject matter of insurance at ill will for deceiving the insurer of insurance monies;
(2) falsely claiming that an event insured against has occurred before such event has actually occurred for deceiving the insurer of insurance monies;
(3) causing an event insured against to occur at ill will that involves property loss for deceiving the insurer of insurance monies;
(4) causing personal insurance event, such as the death, injury, disability or illness of the insured to occur at ill will for deceiving the insurer of insurance monies, or
(5) forging or altering documents, information or other evidence relating to an event insured against; instigating, abetting or bribing others to provide false documents, information or other evidence, to falsify a cause of the event or overstate the extent of the loss for deceiving the insurer of insurance monies.

Where the circumstances of any of the acts set forth in the preceding paragraph are not serious to constitute a criminal offense, an administrative penalty shall be imposed in accordance with the relevant State regulations.

Article 132: Where an insurance company or its working personnel withhold , in the course of insurance operations, important details relating to an insurance contract, deceive the proposer,

the insured or the beneficiary or refuse to perform the obligation of paying insurance monies as stipulated in the insurance contract, and thus a criminal offense is constituted, criminal liability shall be pursued according to law. Where no criminal offense is constituted, the financial supervision and control department shall impose a fine of between Rmb 10,000 and Rmb 50,000 on the insurance company. Sanctions and a fine of no more than Rmb 10,000 shall be imposed on the working personnel who committed the illegal acts.

Where an insurance company or its working personnel hinder proposers to perform, or induce proposers to not to perform, their duty of disclosing true details, or promise the proposer, the insured or the beneficiary an illegal rebate on the insurance premium or other benefits, the financial supervision and control department shall order rectification and impose a fine of between Rmb 10,000 and Rmb 50,000 on the insurance company. sanctions and a fine of no more than Rmb 10,000 shall be imposed on the working personnel who committed the illegal acts.

Article 133: Where an agent or an insurance broker deceives the proposer, the insured or the beneficiary in the course of his business operations, the financial supervision and control department shall order rectification and impose a fine of between Rmb 10,000 and Rmb 50,000. Where the circumstances are serious, the "Permit for Insurance Agency Business Operations" or the "Brokerage Permit" shall be revoked. Where a criminal offense is constituted, criminal liability shall be pursued according to law.

Article 134: Where the working personnel of an insurance company fabricate an event insured against which never occurred and make a sham settlement at ill will by taking advantage of their positions, thereby deceiving the insurer of insurance monies, their criminal liability shall be pursued according to law.

Article 135: Where the provisions of this Law are violated by establishing an insurance company without authorization or by illegal engaging in commercial insurance activities, criminal liability shall be pursed according to the law and the financial supervision and control department shall ban the company or the activities. Where the circumstances are not serious to constitute a criminal offences, an administrative penalty shall be imposed.

Article 136: Where this Law is violated by engaging in insurance operations exceeding the

approved scope of business, the financial supervision and control department shall order rectification and the return of the insurance premiums received and where there is illegal income, confiscate the illegal income and impose a fine of one to five times the amount of the illegal income; where there is no illegal income, it shall impose a fine of between Rmb 100,000 and Rmb 500,000. Where rectification is not made within the specified term or serious consequences are caused, it shall order the suspension of business for rectification or revoke the "Permit for Insurance Business Operations".

Article 137: Where this Law is violated by making a change without authorization in particulars such as the name, articles of association or registered capital of an insurance company, the business site of an insurance company or a branch office, etc., the financial supervision and control department shall order rectification and impose a fine of between Rmb 10,000 and Rmb 100,000.

Article 138: Where any of the following acts is committed in violation of this Law, the financial supervision and control department shall order rectification and impose a fine of between Rmb 50,000 and Rmb 300,000; where the circumstances are serious, it may restrict the scope of business, order cessation of the acceptance of new business or revoke the "Permit for Insurance Business operations":

(1) failure to pay a deposit in accordance with regulations or use of such deposit in violation of regulations;
(2) failure to allocate or carry over funds to the portfolio reserve or outstanding loss reserve in accordance with regulations;
(3) failure to make allocations to the insurance protection fund or common reserve;
(4) failure to reinsure an insurance in accordance with regulations;
(5) employment of insurance company funds in violation of regulations;
(6) establishment of a branch office or representative office without approval; or
(7) division or merger without approval.

Article 139: Where any of the following acts is performed in violation of this Law, the financial supervision and control department shall order rectification and where rectification is not made within the specified term, impose a fine of between Rmb 10,000 and Rmb 100,000:

(1) failure to submit relevant report, statements, documents and information in accordance with regulations; or

(2) failure to submit the insurance clauses and premium rates for the proposed types of risk.

Article 140: Where any of the following acts is performed in violation of this Law, the financial supervision and control department shall order rectification and impose a fine of between Rmb 100,000 and Rmb 500,000:

(1) provision of sham reports, statements, documents or information; or

(2) rejection or hindrance of lawful inspection and supervision.

Article 141: Where any of the following acts is performed in violation of this Law, the financial supervision and control department shall order rectification and impose a fine of between Rmb 50,000 and Rmb 300,000:

(1) providing coverage in excess the insured sum and the circumstances are serious; or

(2) underwriting insurance for a person without capacity for civil acts where the death of such person is set as the condition for payment of the insurance monies.

Article 142: Where this Law is violated by engaging in illegal insurance agency or brokerage activities without having obtained a "Permit for Insurance Agency Business Operations" or a "Brokerage Permit", the financial supervision and control department shall ban the activities, confiscate the illegal income and impose a fine of five to ten times the illegal income. Where a criminal offense is constituted, criminal liability shall be pursued according to law.

Article 143: In case of senior management and other personnel of an insurance company who are directly responsible for acts in violation of this Law that do not constitute a criminal offense, the financial supervision and control department may, depending on the circumstances, issued a warning, order a replacement of such personnel and/or impose a fine of between Rmb 5,000 and Rmb 30,000.

Article 144: Where damages are caused to others as a result of violation of this Law, civil liability shall be borne according to law.

Article 145: Where applications for establishment of an insurance company that fails to meet the requirements specified by this Law are approved or where applications of insurance agents or insurance brokers who fail to meet the requirements are approved, administrative sanctions shall be imposed; where the circumstances are serious to constitute a criminal offense, criminal liability shall be pursued according to law.

Article 146: Where personnel of the financial supervision and control department abuse power, are involved in graft or dereliction of duty in the course of supervision and control of the insurance industry, and thus a criminal offense is constituted, criminal liability shall be pursued according to law; where no criminal offense is constituted, administrative sanctions shall be imposed.

PART EIGHT: SUPPLEMENTARY

Article 147: Marine insurance shall be governed by the relevant provisions of the Maritime Law. Matters not provided for in the Maritime Law shall be governed by the relevant provisions of this Law.

Article 148: The establishment of insurance companies with foreign entity or the establishment of branches in the People's Republic of China by foreign insurance companies shall be governed by this Law. Where laws or administrative regulations provide for otherwise, the provisions of such laws or administrative regulations shall apply.

Article 149: The state shall support the development of insurance business for agricultural production. Agricultural Insurance shall be separately provided for by laws or administrative regulations.

Article 150: Insurance organizations of a nature other than insurance companies provided for in this Law shall be separately provided for in laws or administrative regulations.

Article 151: Insurance companies established upon approval in accordance with State Council regulations prior to the implementation of this Law shall be maintained. Those which do not meet all the requirements provided herein shall meet such requirements provided herein within

a specified time limit. Specific procedures shall be provided for by the State Council.

Article 152: This Law shall be effective as of 1 October 1995.

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ABBREVIATIONS

ABI, Association of British Insurers

CCP, Chinese Communist Party

CIRC, China Insurance Regulation Commission

CNLA, China Maritime Law Association

FOS, Financial Ombudsman Service (UK)

FSCD, Financial Supervision and Control Department

GATS, General Agreement on Trade in Services

GICP, General Insurance Code of Practice (Australia)

GDP, Gross Domestic Product

GMD, Guo Ming Dang

GNP, Gross National Product

IAC, Insurance Contracts Act 1984 (Australia)

IOB, Insurance Ombudsman Bureau (UK)

LAA, Life Assurance Act 1774 (UK)

MIA, Marine Insurance Act 1906 (UK)

MWPA, Married Women Property Act 1982 (UK)

NPC, National People's Congress (PRC)

PBC, People's Bank of China

PICC, People's Insurance Company of China

PRC, People's Republic of China

RMB, Ren Min Bi (Chinese Yuan)

SGIP, Statement of General Insurance Practice

WTO, World Trade Organization